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S. 408, A BILL TO AUTHORIZE AND PROVIDE PROGRAM LEVELS FOR THE SMALL BUSINESS ADMINISTRATION FOR FISCAL YEARS 1986, 1987, AND 1988

HEARINGS

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 408, A BILL TO AUTHORIZE AND PROVIDE PROGRAM LEVELS FOR THE SMALL BUSINESS ADMINISTRATION FOR FISCAL YEARS 1986, 1987, AND 1988

FEBRUARY 21, 28, AND MARCH 7, 1985

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S. 408, A BILL TO AUTHORIZE AND PROVIDE PROGRAM LEVELS FOR THE SMALL BUSINESS ADMINISTRATION FOR FISCAL YEARS 1986, 1987, AND 1988

THURSDAY, FEBRUARY 21, 1985

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room SR 428A, Russell Senate Office Building, Hon. Lowell Weicker, Jr. (chairman of the committee) presiding.

Present: Senators Weicker, Nickles, Kasten, Bumpers, Sasser, Dixon, and Boren.

Staff present: Robert J. Dotchin, staff director; R. Michael Haynes, chief counsel; John W. Ball III, minority chief counsel; and Dorothy C. Olson, hearing clerk.

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, COMMITTEE ON SMALL BUSINESSS

The CHAIRMAN. The committee will come to order.

Today we begin 2 days of hearings to consider S. 408, a bill sponsored by myself, Senator Dale Bumpers, and others to fund the SBA programs and activities for the next 3 years.

Now, it was the original plan to have Mr. Stockman be the leadoff witness. As you know, he was taken ill early this morning, and he is apparently feeling better now. We certainly hope he is feeling better.

What I have done is rearrange the hearing order. Originally the hearings were scheduled for today and for Monday. I have canceled Monday's hearing to accommodate Mr. Stockman, in the hope that a schedule can be worked out between the committee and the Director of OMB. I would suspect that the second hearing will take place sometime next week, but it will not be on Monday.

Today we will followthrough with all of the rest of the witnesses as scheduled. Next week the second hearing will take place. It will include Mr. Stockman and also, as scheduled, we hope to be hearing from the present Administrator.

In any event, the record to date certainly is clear insofar as Mr. Stockman's recommending, and the President's endorsing, the elimination of the Small Business Administration.

I was particularly disturbed to read of Mr. Stockman's reference to the SBA as a "rathole." That rhetoric falls far short of the precision of thought expected of a Director of the Office of Management and Budget. Insofar as this hearing and the hearings next week are concerned, verbal graffiti will not substitute for facts.

In 1953, President Dwight Eisenhower, along with Congress, passed Public Law 163 directing that Government should "aid, counsel, assist, and protect insofar as possible the interests of small business concerns in order to preserve free competitive enterprise."

Under the leadership of President Ronald Reagan's appointee James Sanders, the Small Business Administration and Congress have worked to fulfill that mandate excellently and efficiently as never before. At a time of documented record-high employment and unemployment, both the executive and legislative branches recognized the importance of delivering on a stewardship that is responsible for 80 percent of the new job creation in this country.

Now the President and David Stockman want to recant. If the facts and logic are the basis for their about-face, they should prevail. If such is not the case, then a different result should issue.

In any event, the Nation cannot afford a mistake on this matter. With the antitrust activities of the Justice Department being essentially nil and with the Federal Trade Commission pulling back into its shell, only competition can protect the consumer from high prices and inferior products. Small business ensures that competition. The Small Business Administration is here to assure small business.

Senator Bumpers.

STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator Bumpers. Mr. Chairman, I have a prepared statement which I ask unanimous consent be inserted in the record.

I would just make a few comments.

First of all, I want to say that Senator Weicker and I, in preparing this legislation, were cognizant of the budget constraints that we are all laboring under. This bill has been drafted with that in mind.

However, it has also been drafted with a view toward the proposal that SBA shut down and some programs moved to the Commerce Department, and whether the Commerce Department really a suitable focal point for 14 million small businesses in this country? Is it really a focal point? Better said, is Congress really showing its concern for not only that many businesses, but the kinds of businesses that create 80 percent of all the new jobs created in this country every year?

I think it is important that Congress demonstrate not just a concern for political purposes but a genuine concern for the future of small business when small business is generating that many jobs in the country.

In a poll of banks in this country which had participated in the 7(a) program; GAO found that of all the loans made under the Guaranteed Loan Program through those banks, 82 percent of those loans either would not have been made or would have been made under much more stringent credit conditions.

When you consider the list of success stories, and I am not going to go through all the list of the companies of this country—Apple Computer, for example; Digital Switch, and the list goes on; since 1976 that are today paying $200 million a year in income taxes to the U.S. Treasury, it is very difficult to classify the SBA as a waste or a failure with these kinds of success stories.

The banks did not say, but it is a common knowledge, that banks very seldom make loans longer than 5 years duration to small business, and particularly small businesses that are just cranking up using venture capital, and so on.

What we would be saying is, if you abolish this program as it is right now—and we admit it can be scaled back, but if you abolish it—you are saying to all the future Apple Computers and Digital Switches that there is no place for them.

Finally, I am really anxious to hear Mr. Stockman come and defend some of the figures that I keep reading in the paper about the supposed savings. For example, I think they say that in 1986 alone we would save $1.467 billion. That is almost $1.5 billion.

The thing that I do not understand is this: I sit on the Appropriations Committee, as does the chairman of this committee, and we both sit on the State, Justice and Commerce Subcommittee, and if you read that appropriation bill, you will find that we only appropriate $700-and-some million a year to the SBA. It is very difficult to see how you are going to save $1.5 billion in 1986 alone.

I want to hear how and why you are going to sell the loan portfolio that SBA owns for 19 percent of face value. I want to know why that is fiscally responsible, considering the budget constraints.

While it is not my intent to beat up on David Stockman—I prefer to do that from the vantage point of a Senator from a rural State who is worried about farmers going under—I do want for this committee to take testimony and hear the justification for some of what seem to me to be outrageous claims that could be savings by the abolition of an agency that serves so many businesses every year.

Mr. Chairman, as I say, I have a formal statement prepared, and I ask unanimous consent it be inserted in the record.

The CHAIRMAN. The statement will be included in the record in its entirety.

[The prepared statement of Senator Bumpers follows:]

STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

Mr. Chairman, today the Senate Small Business Committee opens hearings on legislation that Chairman Weicker and I, joined by Senators D'Amato, Nunn, Rudman, Sasser, Kasten, Pressler, and Dixon introduced February 6th to authorize the programs of the Small Business Administration for fiscal years 1986 through 1988. Senator Weicker and I made some very difficult choices in drafting this legislation. The final product is a reasonable compromise that reflects this committee's serious commitment to fiscal responsibility, as well as its committment to maintaining the Federal Government's historical role in providing certain basic, important services to the Nation's small businesses.

The Senate's consideration of this authorization bill comes at a critical time for the SBA because, as we all know, the Office of Management and Budget has targeted SBA for elimination. The administation has not, however, proposed any legislation to carry-out the abolition of the Agency, and in my view, it is appropriate and indeed our duty as members of this committee to go forward with the normal authorization process. On the other hand, the administration's call for outright abolition of the SBA will focus our debate, to some extent, on whether the Small Business Administration should be preserved as an institution, and, if so, which of its programs should be maintained and which should be trimmed in the interest of deficit reduction. Therefore, this committee thought it particularly appropriate to invite, as the lead witness in this hearing, Mr. David Stockman, the Director of the Office of Management and Budget and one of the chief advocates of abolishing the Small Business Administration.

One of the greatest challenges facing Congress is to come up with a plan to deal with Federal deficits that have more than doubled in the past 4 years. We must take drastic measures to contain all areas of Government spending and reduce many programs. No agency can be immune. In this authorization bill, we have made reductions in the SBA's budget authority, cutting out whole programs that many of us have supported in the past, but now agree we simply cannot afford. Yet, this bill will preserve the SBA as an institution that serves small business; its primary missions of providing financial and technical assistance to the Nation's 15 million small businesses will remain intact. We have drafted this authorization bill with fiscal responsibility foremost in mind, and if this bill is enacted into law, the Small Business Administration will certainly be making its just contribution to deficit reduction.

The giant deficits we're facing are a direct result of the 1981 tax cuts and the enormous increase in military spending that has been underway for the past 4 years. When President Reagan first took office he led the fight to reduce the size of the Federal bureaucracy. In 1981, we made large cuts in Federal programs, many of which needed to be trimmed back or eliminated. However, the budget savings achieved by these cuts was more than offset by increases in military spending, and it has now also been more than equalled by the increase in interest payments on the national debt resulting from recent Federal deficits.

Now the administration plans to continue on its present course, to take a meat axe to the domestic side of the budget, to transfer that savings to the military side of the budget and to more debt service, and then to somehow grow our way out of the debt crisis we're facing. We must consider how this country can expect to grow its way out of anything if we turn our backs on the sector of our economy that accounts for the great preponderance of economic growth and for 80 percent of new jobs, small business.

Mr. Stockman's call for abolition of the SBA raises a number of questions. How much money would be saved? Is there no longer a gap in long-term credit available to small business, which has always been the prime rationale for SBA lending programs? Who would fulfill small businesses long-term lending needs? What would happen with disasters? Would the President tell tornado victims to go to the Red Cross for a loan? Would the new, low-profile administration under the Department of Commerce be an effective voice for small business within the executive branch? What would be the cost of this new bureaucracy within the Commerce Department? These are questions that the advocates of eliminating SBA must answer in making their case.

OMB's claim that abolition of SBA would save $1.467 billion in fiscal year 1986 and $5.3 billion over 3 years gives pause to anyone who has read the Commerce-State-Justice appropriation bill lately. SBA's appropriation is contained in that bill, and I'm a member of that subcommittee. I know that in the fiscal year 1984 bill, we only appropriated $730,040,000 for the SBA. OMB has produced its figures through down-right misstatements of fact and a plan to sell the SBA loan portfolio, which is foolish at best. OMB would sell the loan portfolio for an estimated 19.3 percent of its face value, raising approximately $2.3 billion. On the other hand, based on SBA's historical collection data, it would collect at least 80 cents on the dollar. Thus, through continued portfolio management, the Agency would collect $9.6 billion, or $7.3 billion more than OMB's fire sale proposal.

Mr. Stockman's call for an end to Small Business lending programs ignores a basic finding of fact by Congress many years ago: That there exists a very serious gap in the availability of long-term financing for small business. Banks generally do not lend for more than 5 years, and most small businesses are not in a position to make a public offering of stock. This authorization bill eliminates general business direct loans, saving $92 million in outlays for fiscal year 1986 and $171 million in budget authority. This bill also makes savings of approximately $100 million by eliminating the nonphysical disaster program. I have supported this program in the past, but I have concluded that controlling spending must take priority. The physical disaster program is maintained. Direct loans are also maintained, at last year's levels, to assist veterans, the handicapped, and minority enterprise small business investment companies.

The SBA does some of its most important work in its nonlending programs: Advocacy, management assistance, procurement assistance, innovation, research and technology, and the Service Corps of Retired Executives. These are very small budget items, but they provide important assistance, without which many small businesses would go under or never get started. Some of these programs were also created to force Government agencies to reduce regulations that burden small business and to create greater opportunities for small business to sell goods and services to the Federal Government. These programs are maintained in our bill. The administration proposes to transfer them to a new agency within the Department of Commerce.

The Administrator of SBA, as head of an independent Federal agency, has access to the highest councils of policymaking. The proposed new Administration for Enterprise Development would, I presume, be headed by a Deputy Assistant Secretary (DAS). Does anyone seriously believe that a DAS at Commerce, of which there are presently 24, can give the same voice to small business that the Administrator would?

Finally, what would this new bureacracy cost? It sounds like the only net reduction that the OMB proposal would make in employees would be the people who make loans, since even those who service the loans would be transferred to Treasury. Presumably, additional office space would be needed for the transferred employees. The authorization bill we're considering provides for a freeze on salaries and expenses at the Agency for fiscal year 1986, with no cost of-living adjustment whatsoever until 1987. I have seen no estimate from OMB of the cost of the new Treasury Department mini-SBA.

In summary, I believe the proposed authorization bill shows responsibility and restraint on the part of this committee. The burden is now on the Office of Management and Budget to justify its proposal both from both a policy and a budget standpoint. A number of claims and accusations have come out of OMB in recent weeks, and I look forward to hearing a thorough explanation of them. In the meantime, this committee will go about its business, and report out an authorization bill.

The CHAIRMAN. Senator Nickles.

STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator NICKLES. Thank you, Mr. Chairman.

I, likewise, have a statement, and I would appreciate your inserting that into the record.

I would like to make a couple of general comments.

One, I had the opportunity to witness Senator Bumpers badger Dave Stockman yesterday, and he does quite well.

Is Mr. Stockman going to be here Monday?

The CHAIRMAN. The matter of his appearance is now being worked out between the committee and Mr. Stockman. I suggest that depends on the state of his health, which hopefully will be in good shape by next week. We wish him well, and I am sure the hearing will be put together we hope sometime next week, not on Monday. I have canceled the Monday hearing.

Senator NICKLES. You have canceled Monday. I appreciate that. I look forward to his appearance.

Concerning the proposal, I guess I have mixed opinions on it. As the chairman is well aware, I think that probably the best thing we could do for small business is get the deficit down. Like many in the Senate, I think we are going to have to make reductions in every area, including some of those that we find that we are quite supportive of. If we are really going to be able to get the enormous deficits down, I think we are going to have to cut in every area, and that may mean SBA. Whether it means abolishing the SBA is another matter.

I appreciate and I compliment the chairman and Senator Bumpers for their proposal, which, as I understand, would save a considerable amount of money. That may well be the direction that the Senate and the Congress would wish to go.

Likewise, at the same time, I am open to the proposal of looking at whether or not we should abolish any agency and have them come forward to justify both their existence and the dollars that they are receiving and find out which programs are working and which ones are not working.

I can tell this committee that I have had meetings in Oklahoma as late as last week. We had the district director of the SBA in Oklahoma City basically give a review of a lot of the programs in the State, and he was quite adamant in the fact that he was helping small business. Again, we have to look at this.

I was a small business person before my days in the Senate, and the businesses that I was involved in had no connection, with the SBA. I think facts would point out that more than 90 percent of the businesses in this country have not received any assistance in any way from the Small Business Administration. I think we need to look at all these facts.

We are privileged today to have an Oklahoman, Bob McCormick, whose bank has been very active in SBA lending. I look forward to his comments. Knowing him as a friend and knowing the activities that they have had in Oklahoma, I do know that they have helped a lot of businesses.

I think the testimony today and the panelists that you have scheduled should help us shed light on this subject. I think your opening statement, Mr. Chairman, is one that really bears the most merit. Let's look at the facts and maybe get beyond some of the rhetoric and get down to this: is the SBA worth the dollar investment? Is it worth the contribution? Is it actually paying its way? Is it getting more and more jobs created that would not be created otherwise? I hope that maybe in the next couple days, and possibly with some field hearings, we will be able to come to a resolution of that question.

[The prepared statement of Senator Nickles follows:]

STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Mr. Chairman: The Administration has proposed savings of $1.5 billion in fiscal year 1986 by abolishing the Small Business Administration. These savings are made in light of overall budget restraint and control. The rationale for these savings is that overall economic recovery will stimulate small business far better than will the SBA programs which aids less than 2 percent of all small businesses.

The bulk of the savings are attributed to the elimination and the sale of the agencies' business and disaster loan programs. Smaller savings are achieved in salaries and expense, part of which will be transfered to the Commerce Department by the establishment of Administration for Enterprise Development and Opportunity.

The Administrations' proposal is not all unjustified. Much of the abuse of the loan and support programs of the SBA have come under the scrutiny of this committee. Default outlays needed to cover these defaulted loans have increased pressure on the deficit.

However, there are the bright spots in the SBA programs. We will hear from one such success story from Oklahoma here today. While we must tighten our belts with regard to federal spending, we must ensure that beneficial aspects of the programs are retained.

In the case of guaranteed lending, reductions will ultimately have to be made. It should be done, however, by targeting those loans and institutions which have an historically high default rate.

I look forward to the testimony of the witnesses and I will use what I learn today to help formulate my decision on the SBA's budget.

The CHAIRMAN. Thank you very much, Senator Nickles.

Senator Dixon.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DIXON. Mr. Chairman, I was pleased to join you and my friend Senator Dale Bumpers in cosponsoring S. 408, the reauthorization legislation for the Small Business Administration.

The current administration, Mr. Chairman, in its desire to reduce the deficit, has chosen to propose eliminating the Small Business Administration at a time when the SBA is deeply and effectively involved in assisting small businesses throughout this country through its guaranteed loan programs, and through programs such as the procurement breakout centers representatives.

Last year, as you know, Mr. Chairman, you and I, along with other members of this committee, worked on S. 2489, the Small Business Competition Enhancement Act of 1984, a bill which became law.

During our hearings on that bill, we saw proof that the Small Business Procurement Center representatives in a pilot program had been highly successful in increasing the opportunities for competitive procurements, and according to the General Accounting Office, and I quote:

> SBA's breakout efforts have resulted in large dollar savings in regulations to the program cost. During the initial 18 months of the BPCR program, the four BPCR's were able to breakout to competition 294 items that had previously been procured on a sole-source basis and the Government realized savings of over $7,319,913, the difference between the last sole-source price and the first competitive price.

This savings was realized at four Air Force logistics centers. S. 2489 expanded this program to include all Federal procurement centers which awarded contracts totaling at least $150 million.

Mr. Chairman, the administration says its goal is to reduce the deficit, but in this case it is proposing to put out of business an agency which is helping to reduce the deficit.

I hope today's and next week's hearings send a strong message to the administration that the Small Business Administration must be retained.

I thank the Chair.

[The prepared statement of Senator Dixon follows:]

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

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I hope today's and next weeks hearings send a strong message to the Administration that the SBA must be retained.

The CHAIRMAN. Thank you very much, Senator Dixon.

[The prepared statement of Senator Sasser follows:]

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE

Mr. Chairman, as an original cosponsor of S. 408, legislation which will keep the Small Business Administration alive, I commend you for holding these hearings today. These hearings are particularly timely given the President's request to abolish SBA and David Stockman's recent remarks slandering the agency any many in the small business community.

As the chairman has pointed out, Mr. Stockman was to be our lead off witness today and I had looked forward to his appearance with great anticipation, as no doubt many of you have. I would like to have explored further Mr. Stockman's characterization of SBA as a "rathole" and a billion dollar waste, but that will have to wait for our second round of hearings on this bill.

What I found particularly troubling about Mr. Stockman's remarks was his sweeping condemnation of all the programs administered by the SBA. As has been pointed out, there are problems with some of the programs administered by the SBA. Those within the Agency would be the first to admint that. To believe otherwise is to suggest that Jim Sanders runs a perfect agency, a perhaps unattainable goal.

But you won't find anyone in the Agency, on this committee or in the small business community who would contend that all the programs operated by the SBA are worthless. Quite the contrary is true and the legislation we are focusing on today emphasizes many of the excellent programs now run by the SBA. For example, the Certified Development Company Program is a major economic development tool in many communities. This program has created over 58,000 jobs through the end of 1984 at a cost of only $7,600 per job to the SBA. In Tennessee, this program is generating nearly twice the number of jobs than was originally projected by SBA officials.

The Guaranteed Lending Program operated by the Agency is another success story. Contrary to the assertions of Mr. Stockman's budgetary henchmen, this program is not "economically counterproductive." Indeed, a General Accounting Office survey of SBA's Guaranteed Loan Program concluded that this program assists and benefits a significant and important segment of small businesses in need of long-term debt financing. In addition, this program also facilitates larger and longer-term loans than banks would normally make to small business. In fact, this survey of lenders by GAO found that about 82 percent of the lenders said that the small businesses to which they made loans would not have been financed without the SBA guarantee, or would have had different financing terms and conditions.

Similiar testimonials will no doubt be made by many of our witnesses today. And while some may point to problems within the Agency, the underlying theme will remain the same: The Small Business Administration should be kept alive. Our introduction of S. 408 sends a strong signal that there are those of us in Congress who agree. Moreover, as shown by these hearings today, we are willing to take the steps necessary to keep the Agency intact so it can continue to provide valuable services to this Nation's small business community. In short, the blantant disregard for the economic well-being of our country's small firms displayed in the budget proposal and in Mr. Stockman's comments cannot and will not be tolerated.

[The prepared statement of Senator Kasten follows:]

STATEMENT OF HON. BOB KASTEN, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Thank you, Mr. Chairman.

The Small Business Administration has been an active partner in the affairs of small businesses and entrepreneurs since 1953. The SBA was created to do more than simply lend money. Its purpose was to aid and assist small companies, acting as an independent lobby within the Federal Government (i.e., "helping small companies get government contracts").

Small businesses are the backbone of the American economy! Businesses with fewer than 20 workers provide two-thirds of all total new jobs available, thus generating a substantial portion of the gross national product.

As a cosponsor of Senators Weicker and Bumpers authorization bill for fiscal year 1986-88, I support a freeze of SBA funding for programs in fiscal year 1986 at fiscal year 1985 levels. The bill also achieves additional savings through elimination of certain other unnecessary programs.

This is a good starting point. But much remains to be done to bring total outlays within the SBA down to a responsible, and more manageable level. I will work to do this, without sacrificing the integrity and resourcefulness of the Small Business Administration.

Let us look to the future. Enormous problems associated with the SBA in past years have been corrected. The Reagan administration has turned the agency into an efficient and highly-praised advocate for the small business community's needs, and Administrator Jim Sanders is correctly hailed even by critics as perhaps the best head the agency has ever had.

The SBA has certainly not been a do-nothing agency for the past 4 years, and it has deliberately shifted its focus away from direct lending—which encourages dependence on the Federal Government—and towards self-help activities. In other words, SBA's new role has been one of lending guidance and encouragement to small businesses, and not one of propping up failing or inefficient firms.

Wisconsin small business groups—and individuals—are expressing opposition to the elimination of SBA. They have to work with the SBA on a daily basis, so these people know better than most whether the agency is a help to them or not. On a trip back to my State recently, Wisconsinites have uniformly said to me that the agency is an effective and much-needed advocate for their point of view.

The SBA has, for instance, been successful in increasing federal purchases of products—including spar parts—from small firms in Wisconsin, and SBA guarantees have enabled countless Wisconsin businesses to get bank loans during times of tight money.

For example, one businessman in Wisconsin found out just how important the SBA was when trying to raise capital for some unexpected expenditures. After buying a MIlwaukee metal manufacturing and servicing company, Fred Luber ran into some unanticipated obstacles. [From the Wisconsin Business Journal, January 1985.]

In 1966, Fred Luber found out the expressway was going to be built where his Super Steel plant was located—not in 3 years, as he had expected, but in just 3 months. Luber had purchased the company not expecting to need a new building. The Small Business Administration came to his aid.

With an SBA-guaranteed loan through Bay View Bank, Luber purchased a building on Capitol Drive. He began with 16 employees. Now he has over 400 emloyees. He moved his company from a small plant to a facility with more than 400,000 square feet. The plant is now at doing close to $30 million in business per year.

This is just one example of how Wisconsin companies have used the SBA as a growth-support partner when they needed help. If small businesses are as important to the economy as the President says, why eliminate the only agency in the Federal Government whose job it is to promote small business growth?

Thank you, Mr. Chairman.

The **CHAIRMAN**. We will now proceed to our first panel, which consists of Mr. Arthur Chase, president of the Arthur Chase Management Corp. of Westborough, MA; Mr. Edward Lewis, publisher-chief executive, Essence Communication, of New York City, NY; Mr. John Jonas, Jr., founder and president of Cerebral Palsy Research Foundation of Kansas; Mr. Joe Childs, president and general manager of the Center Industries Corp. of Wichita, KS; and, last, Mr. John Carlson, executive vice president and chief executive officer of Cray Research, Minneapolis, MN.

For the order of the witnesses, I gather that Mr. Carlson will lead off, followed by Mr. Childs, Mr. Jonas, Mr. Lewis, and then Mr. Chase.

Gentlemen, I would like to express my deep appreciation for the great effort on each one of your parts to be here today.

What we are trying to ascertain is the effectiveness of the small business programs, that is, what is right and what is wrong. And there is no better place to find that out than from those who have been involved in one or more of the small business programs over the years.

With those words of welcome—Mr. Carlson?

Senator BUMPERS. Mr. Chairman, will you yield before we hear from the witnesses?

The CHAIRMAN. Yes.

Senator BUMPERS. It has not been said for the record, nor for the press, and I think this would be an appropriate time to do this—to point out that the bill which we have introduced here, and I pointed out in my opening remarks that Senator Weicker and I are cognizant of the budget restraints; we want to do our part to help in reducing the deficits as much as everybody else—our bill actually saves over $600 million over the next 3 years. I just wanted to state that for the record.

The CHAIRMAN. Correct.

Mr. Carlson.

STATEMENT OF JOHN F. CARLSON, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, CRAY RESEARCH, INC., MINNEAPOLIS, MN

Mr. CARLSON. Mr. Chairman and members of the distinguished committee, my name is John Carlson. I am executive vice president and chief financial officer of Cray Research.

Cray Research is the world's leading supplier and developer of supercomputers. We were founded in 1972. Since that time, we have grown to over 2,200 employees and a customer base that spans 10 countries.

Financially, our success has been equally gratifying. Since our shipment of the first computer in 1976, our revenues have grown to in excess of $230 million in 1984. Our net earnings in 1984 were $45.4 million.

Perhaps equally as significant is the fact that when we first started developing supercomputers, we thought we had a market of 80 to 100 potential customers. As of the end of 1984, we had installed 85 machines in these 10 countries that I mentioned.

Thank you in particular, Mr. Chairman, for inviting me to speak to the committee with respect to the Small Business Investment Corporation Program and what its impact has been on Cray Research.

It is fair to say that the success I have described might never have been without this program. So it is a unique privilege that I recall for you some of the financial routes of Cray Research.

Since our story is relatively simple, my prepared statement will be quite short and to the point. I will try to demonstrate the crucial role that the SBIC has played in the Cray Research success story and quantify for the benefit of the committee the return that the taxpayer and the Government has received on its investment.

Finally, I will make a few observations concerning the nature of the program from our—Cray Research's—limited view. I wish to stress at this point, however, that our perspective is simply that of a beneficiary of the venture capital provided by the SBIC Program. We are not an SBIC and are not prepared to discuss the intricacies of the program from that viewpoint.

As I stated earlier, Cray Research was founded in 1972. The initial capital into the company at that point was $2.5 million. The money was essentially collected from Seymour Cray and his friends, and also an initial investment from Control Data Corp. Those of you who know the story know that Seymour Cray left Control Data to found Cray Research.

This financing was sufficient for the first 2 years. Then, in 1974, another round of financing was required. At that time, about $2.7 million was raised, of which $600,000 came from SBIC's. Two SBIC's participated in the second round of financing for Cray Research.

We thought at that time that we would have sufficient money to carry us until we could install our first product. However, in 1975, it became clear that the company could not make it to the initial installation without additional financing. It was at that time that Seymour Cray, the chairman and founder of the company, began to seek additional financing in the midst of a very, very difficult venture capital and other financing market.

After being denied a bank loan, Mr. Cray finally received help from a local SBIC. I stress the word "local" because Seymour Cray was known primarily in the Minneapolis area, and his reputation outside of that area at that point in time was relatively unknown. I think the fact that we had a local SBIC that was familiar with Seymour Cray made the difference.

This SBIC decided to assist Seymour in the financing. They took the lead. Without their initial commitment and lead, others would not have followed; $2.7 million was raised in 1975. Approximately one-half of that money came from SBIC's.

This was sufficient money to carry Cray Research through the initial installation of our beta test site in March 1976 and a successful public offering that took place in the same month.

We continue to receive help from the local SBIC in the form of Mr. Zikerelli's continued leadership as a director of Cray Research. So not only was he instrumental in carrying us through this very pivotal financing period, but has been a significant help to the company through his ongoing participation as a director.

Mr. Chairman, the role of the SBIC Program in securing continuation capital for Cray Research in 1975 cannot be overemphasized. Some claim that if the SBIC had not been there we would have found money anyway. With the benefit of hindsight, we are quick to say that many others would have invested in a company as exciting as Cray Research, but consider how the investor viewed Cray Research in 1975.

We were a company without a product; development schedules had slipped; we had no serious prospects; and we were generally facing a market that people thought was no larger than 80 to 100 potential customers.

In addition, there was competition from much larger organizations: Control Data Corp., Burroughs, TX Instruments, and Goodyear, just to name a few.

Furthermore, if you remember back to 1975, the venture capital market was not what it is today. IPO's were not in vogue. In fact, in 1975 there was not an IPO that took place. Despite this environment the taxpayers, through the SBIC, were willing to make an investment in a startup situation. This was enough to carry Cray Research over and, in effect, save the company.

Beyond the obvious social and broad economic benefits which successful ventures such as Cray Research bring to the country, it seems important to measure the success of the SBIC program in the same terms that venture capitalists might measure their success—overall return on investment.

Since 1977, Cray Research has paid in excess of $83 million in corporate income taxes. Last year alone, 1984, we paid more than $20 million. This year we will pay far in excess of that amount. My understanding is that through the SBIC program in its 26 years of history the total writeoffs have been between $36 and $38 million. On an ongoing basis, if we continue to be successful, we will each year repay in excess of $36 to $38 million.

We have created jobs for over 2,000 people. By the end of 1985, this year, we will have an employment base in excess of 3,000 people around the world.

Another way to measure it is to look back to 1975 and to look at the dollar investment the SBIC's made at that time. The $2 of investment that the SBIC's made in 1975 is today worth $70 in a 10-year period. I think that is a pretty good return for a $2 investment.

In conclusion, Mr. Chairman, I am pleased to appear before you this morning as a representative of our company. More importantly, however, I am appearing as a representative of a large segment of industry that has benefited because America has kept its commitment to the entrepreneurial process that has made our economy flourish. Part of that commitment comes from entrepreneurs like Seymour Cray, who are able to translate our capital into successful products and technology leadership. The other piece of America's commitment, however, comes from those who have a part in creating the financial climate that allows innovation to prosper.

With the SBIC Program, Congress and the taxpayers have provided that climate when it was absolutely critical to Cray Research, and I trust that our successors will find you by their sides as well when they are in need of early financial support.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Carlson follows:]

STATEMENT BY

MR. JOHN F. CARLSON

EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

CRAY RESEARCH, INC.

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 21, 1985

Questions regarding this testimony should be directed to:

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Vice President of Government Relations
Cray Research, Inc.
655 15th Street
Suite 210
Washington, D.C. 20005
(202) 638-6000

STATEMENT SUMMARY

THROUGH THE SUCCESS OF CRAY RESEARCH, INC., THE AMERICAN TAXPAYER HAS REALIZED A DIRECT REVENUE GAIN OF OVER $100 MILLION OVER THE LAST SEVEN YEARS. CRAY'S TOTAL EMPLOYMENT HAS GROWN TO OVER TWO THOUSAND PEOPLE WITH A TOTAL PAYROLL OF OVER $60 MILLION PER YEAR. DESPITE THE COMPANY'S STRENGTH TODAY, HOWEVER, THE COMPANY CAME CLOSE TO FAILING IN 1975 DUE TO LACK OF SUFFICIENT CAPITAL. AT THAT TIME, EMERGENCY VENTURE CAPITAL WAS RAISED FROM SEVERAL COMPANIES, THE MAJORITY OF WHICH WERE FUNDED BY THE SMALL BUSINESS INVESTMENT COMPANY (SBIC) PROGRAM. A NUMBER OF EXPERTS FAMILIAR WITH BOTH THE SPECIFIC CASE AND THE DIFFICULT STATE OF THE VENTURE CAPITAL MARKETS IN 1975 AGREE THAT THE SBIC FUNDING WAS A "MAKE OR BREAK" COMPONENT OF THE FINANCING. PUT ANOTHER WAY, THE TAXPAYERS' INVESTMENT OF LESS THAN $500,000 IN SBIC FUNDING FOR CRAY RESEARCH IN 1975 IS CURRENTLY YIELDING A DIRECT REVENUE RETURN OF OVER $30 MILLION PER YEAR IN CORPORATE AND PERSONAL INCOME TAXES. SINCE 1975, CRAY RESEARCH HAS ALREADY CONTRIBUTED OVER $100 MILLION IN TOTAL TAX REVENUES AND HAS GENERATED OVER TWO THOUSAND JOBS.

THE CRAY RESEARCH EXPERIENCE SUGGESTS THAT THE SBIC PROGRAM IS AN IMPORTANT OPPORTUNITY FOR THE TAXPAYER TO INVEST IN THE MOST DYNAMIC GROWTH AREA OF THE ECONOMY. FURTHERMORE, THIS TYPE OF PROGRAM FOSTERS THE ENTREPRENEURAL ACTIVITY SO STRONGLY ADVOCATED BY THE REAGAN ADMINISTRATION AND SO ESSENTIAL TO ECONOMIC GROWTH. WE THEREFORE RECOMMEND THAT THE PROGRAM BE RETAINED AS AN ACTIVE AND VITAL TOOL OF THE VENTURE CAPITAL COMMUNITY.

SMALL BUSINESS INVESTMENT COMPANY (SBIC)
PROGRAM IMPACT ON CRAY RESEARCH, INC

MR CHAIRMAN, AND MEMBERS OF THIS DISTINGUISHED COMMITTEE. I AM JOHN F. CARLSON, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER OF CRAY RESEARCH, INC., THE WORLD'S LEADING SUPPLIER AND DEVELOPER OF SUPERCOMPUTERS AND SUPERCOMPUTING TECHNOLOGY. SINCE IT WAS FOUNDED IN 1972, CRAY RESEARCH HAS GROWN TO OVER 2100 EMPLOYEES AND A CUSTOMER BASE SPANNING TEN COUNTRIES. FINANCIALLY, OUR SUCCESS HAS BEEN EQUALLY GRATIFYING. SINCE SHIPPING OUR FIRST COMPUTER SYSTEM IN 1976, OUR TOTAL REVENUES HAVE GROWN TO $ 230 MILLION IN 1984, WITH NET EARNINGS OF $45.4 MILLION. PERHAPS MORE SIGNIFICANT, THE SUCCESS OF OUR PRODUCTS HAVE BEEN SUCH THAT OUR CURRENT INSTALLED CUSTOMER BASE IS LARGER THAN THE ENTIRE WORLDWIDE MARKET WAS THOUGHT TO BE WHEN WE SHIPPED THAT FIRST SYSTEM.

THANK YOU, IN PARTICULAR, MR. CHAIRMAN, FOR INVITING ME TO SPEAK WITH YOU CONCERNING THE IMPACT THAT THE SMALL BUSINESS INVESTMENT COMPANY

(SBIC) PROGRAM HAS HAD UPON CRAY RESEARCH. IT IS FAIR TO SAY THAT THE SUCCESS I HAVE DESCRIBED ABOVE MIGHT NEVER HAVE BEEN WITHOUT THAT PROGRAM, SO IT IS A UNIQUE PRIVILEDGE TO RECALL OUR "FINANCIAL ROOTS" BEFORE THIS DISTINGUISHED COMMITTEE.

SINCE OUR STORY IS RELATIVELY SIMPLE, MY PREPARED STATEMENT WILL BE QUITE SHORT AND TO THE POINT. I WILL DEMONSTRATE THE CRUCIAL ROLE THAT THE SBIC PROGRAM HAS PLAYED IN THE CRAY RESEARCH SUCCESS STORY AND QUANTIFY FOR THE BENEFIT OF THE COMMITTEE THE RETURN THAT THE TAXPAYER HAS RECEIVED FOR HIS INVESTMENT. FINALLY, I WILL MAKE A FEW OBSERVATIONS CONCERNING THE NATURE OF THE PROGRAM FROM OUR LIMITED VIEW. I WISH TO STRESS AT THIS POINT, HOWEVER, THAT OUR PERSPECTIVE IS SIMPLY THAT OF A BENEFICIARY OF THE VENTURE CAPITAL PROVIDED BY THE PROGRAM. WE ARE NOT AN SBIC AND ARE NOT PREPARED TO DISCUSS THE INTRACACIES OF THE PROGRAM FROM THAT VIEWPOINT.

I. ROLE OF SBIC CRUCIAL TO CRAY RESEARCH SUCCESS

AS I STATED EARLIER, CRAY RESEARCH WAS FOUNDED IN 1972. THE FIRST FINANCING FOR THE STARTUP WAS PROVIDED BY FIFTEEN PRIVATE INDIVIDUALS AND A LARGE INVESTMENT BY COMMERCIAL CREDIT COMPANY. THIS FINANCING WAS SUFFICIENT TO FUND THE COMPANY UNTIL EARLY 1974, WHEN THE SECOND ROUND OF FINANCING WAS RAISED WITH THE THOUGHT THAT THE COMPANY COULD MAKE IT TO PRODUCT INTRODUCTION WITHOUT ANOTHER MAJOR CAPITAL INFUSION. BY MID-1975 IT WAS CLEAR THAT THE COMPANY COULD NOT SURVIVE WITHOUT A THIRD ROUND OF FINANCING. AT THAT TIME, MR. SEYMOUR CRAY, THE COMPANY FOUNDER AND CHIEF EXECUTIVE, BEGAN TO SEEK ADDITIONAL FINANCING IN THE MIDST OF AN EXTREMELY DIFFICULT VENTURE CAPITAL

MARKET. AFTER BEING DENIED A BANK LINE OF CREDIT ESSENTIAL TO KEEP THE COMPANY GOING FOR MORE THAN TWO MONTHS, MR. CRAY FINALLY RECEIVED HELP FROM AN SBIC THAT AGREED TO ASSEMBLE THE REQUIRED CAPITAL. WHEN THE TASK WAS COMPLETE, ELEVEN CAPITAL COMPANIES, SEVEN OF WHICH WERE SBIC INVESTORS, JOINED TO RAISE $1.8 MILLION. THIS AMOUNT THEN WAS POOLED WITH ANOTHER $500,000 FROM PRIVATE INVESTORS, ENOUGH TO ENSURE THAT CRAY RESEARCH COULD CONTINUE UNTIL ITS SUCCESSFUL PUBLIC OFFERING A YEAR LATER. OF THE $1.8 MILLION, OVER $1 MILLION, OR ALMOST SIXTY PERCENT, WAS FROM SBIC SOURCES.

MR. CHAIRMAN, THE ROLE OF THE SBIC PROGRAM IN SECURING CONTINUATION CAPITAL FOR CRAY RESEARCH IN 1975 CANNOT BE OVEREMPHASIZED. SOME MAY CLAIM THAT IF THE SBIC HAD NOT BEEN THERE, CRAY WOULD HAVE FOUND ANOTHER WAY. OUR VENTURE CAPITALISTS TELL US OTHERWISE. WITH THE BENEFIT OF HINDSIGHT, WE ALL ARE QUICK TO SAY THAT MANY OTHERS WOULD HAVE INVESTED IN A COMPANY AS EXCITING AS CRAY RESEARCH. BUT CONSIDER HOW THE INVESTOR VIEWED CRAY RESEARCH IN 1975: A COMPANY WITH NO PRODUCT, SLIPPING SCHEDULES, NO SERIOUS PROSPECTS, FACING A MARKET GENERALLY THOUGHT TO BE NO BIGGER THAN EIGHTY PROSPECTS WORLDWIDE AND COMPETING WITH WELL FUNDED AND ESTABLISHED COMPETING PROGRAMS AT CONTROL DATA CORPORATION, BURROUGHS, TEXAS INSTRUMENTS, ICL (UNITED KINGDOM), AMONG OTHERS. FURTHERMORE, THE VENTURE CAPITAL MARKET WAS SLUGGISH AND SUCCESSFUL NEW OFFERINGS WERE FEW AND FAR BETWEEN. INTO THIS ENVIRONMENT, THE TAXPAYERS INVESTED LESS THAN $500,000 AND BECAME THE STIMULUS FOR INVESTMENT OF $2.3 MILLION, ENOUGH TO SAVE CRAY RESEARCH.

II. RETURN TO TAXPAYERS FOR SBIC INVESTMENT IS HIGH

BEYOND THE OBVIOUS SOCIAL AND BROAD ECONOMIC BENEFITS WHICH SUCCESSFUL VENTURES LIKE CRAY RESEARCH BRING TO THE COUNTRY, IT SEEMS IMPORTANT TO MEASURE THE SUCCESS OF THE SBIC PROGRAM IN THE SAME TERMS THAT THE VENTURE CAPITALIST WOULD MEASURE HIS SUCCESS: OVERALL RETURN ON INVESTMENT.

AS I STATED EARLIER, WE ESTIMATE THAT THE TOTAL TAXPAYER INVESTMENT IN CRAY RESEARCH WAS LESS THAN $500,000. THE RETURN ON THAT INVESTMENT HAS BEEN, AND CONTINUES TO BE STAGGERING. SINCE WE STARTED MAKING PROFITS, CRAY RESEARCH HAS PAID OVER $83 MILLION IN DIRECT CORPORATE INCOME TAXES. LAST YEAR ALONE THIS FIGURE WAS OVER $20 MILLION. IF WE CONTINUE IN OUR EXPECTED GROWTH PATTERN, THIS FIGURE WILL BY ITSELF PAY FOR THE DIRECT LOAN PORTION OF THE SBIC BUDGET WITHIN THREE OR FOUR YEARS. IN ADDITION TO DIRECT CORPORATE TAXES, SINCE 1976 WE HAVE PAID OVER $195 MILLION IN DIRECT EMPLOYEE PAYROLL. ADDING OUR CORPORATE TAXES TO THE EMPLOYEE TAX REVENUE WHICH OUR EMPLOYEES HAVE BEEN PAYING RESULTS IN A RETURN TO THE TAXPAYER OF WELL OVER $100 MILLION FROM THAT INITIAL $500,000 INVESTMENT, A HEALTHY RETURN BY ANY STANDARD.

OBVIOUSLY, WE CAN ONLY SPEAK TO OUR COMPANY SUCCESS AND WHAT IT HAS MEANT TO THE AMERICAN TAXPAYER. HOWEVER, IT IS EASY TO SEE THAT IT DOES NOT TAKE MANY SUCH SUCCESSES BEFORE THE ENTIRE PROGRAM IS WELL

WORTH THE RISK. IT IS IMPORTANT, THEREFORE, WHEN THE SBIC PROGRAM IS EVALUATED, THAT CRITICS NOT DEFINE SUCCESS IN RAW NUMBERS OF "SUCCESSES" VERSUS "FAILURES." RATHER, THE PROGRAM SHOULD BE EVALUATED FOR WHAT IT IS: AN OPPORTUNITY FOR THE TAXPAYER TO PLAY A PART IN THE VERY HIGH RISK BUT IMPORTANT VENTURE CAPITAL MARKETPLACE.

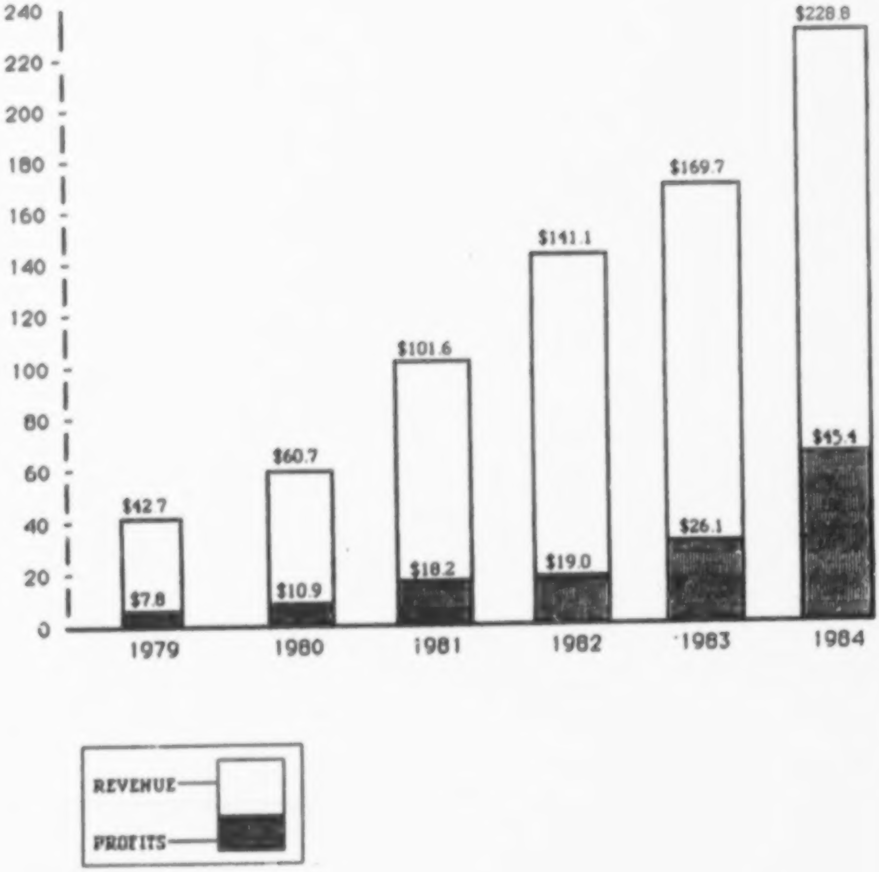
III. CONCLUSIONS

IN CONCLUSION, MR. CHAIRMAN, I AM PLEASED TO APPEAR BEFORE YOU THIS AFTERNOON AS A REPRESENTATIVE OF OUR COMPANY AND OUR INDUSTRY. MORE IMPORTANTLY, HOWEVER, I AM APPEARING AS THE REPRESENTATIVE OF THE LARGE SEGMENT OF SOCIETY THAT HAS BENEFITTED BECAUSE AMERICA HAS KEPT ITS STRONG COMMITMENT TO THE ENTREPRENEUREAL PROCESS THAT HAS MADE OUR ECONOMY FLOURISH. PART OF THAT COMMITMENT COMES FROM ENTREPRENEURS LIKE SEYMOUR CRAY WHO ARE ABLE TO TRANSLATE OUR CAPITAL INTO SUCCESSFUL PRODUCTS AND TECHNOLOGICAL LEADERSHIP. THE OTHER PIECE OF AMERICA'S COMMITMENT, HOWEVER, COMES FROM THOSE OF US WHO HAVE A PART IN CREATING THE FINANCIAL CLIMATE THAT ALLOWS INNOVATION TO PROSPER. WITH THE SBIC PROGRAM, THE CONGRESS AND THE TAXPAYERS HELPED PROVIDED THAT CLIMATE WHEN IT WAS CRUCIAL TO CRAY RESEARCH. I TRUST THAT OUR SUCCESSORS WILL FIND YOU BY THEIR SIDES AS WELL.

THANK YOU VERY MUCH.

EARNINGS

(Dollars in Millions)



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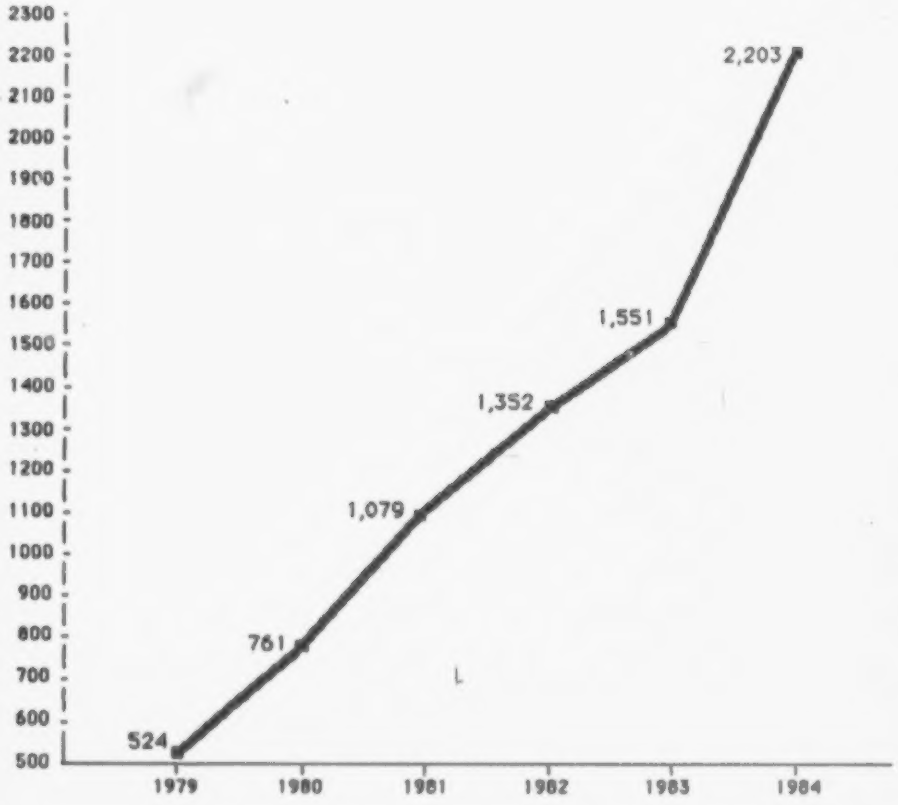
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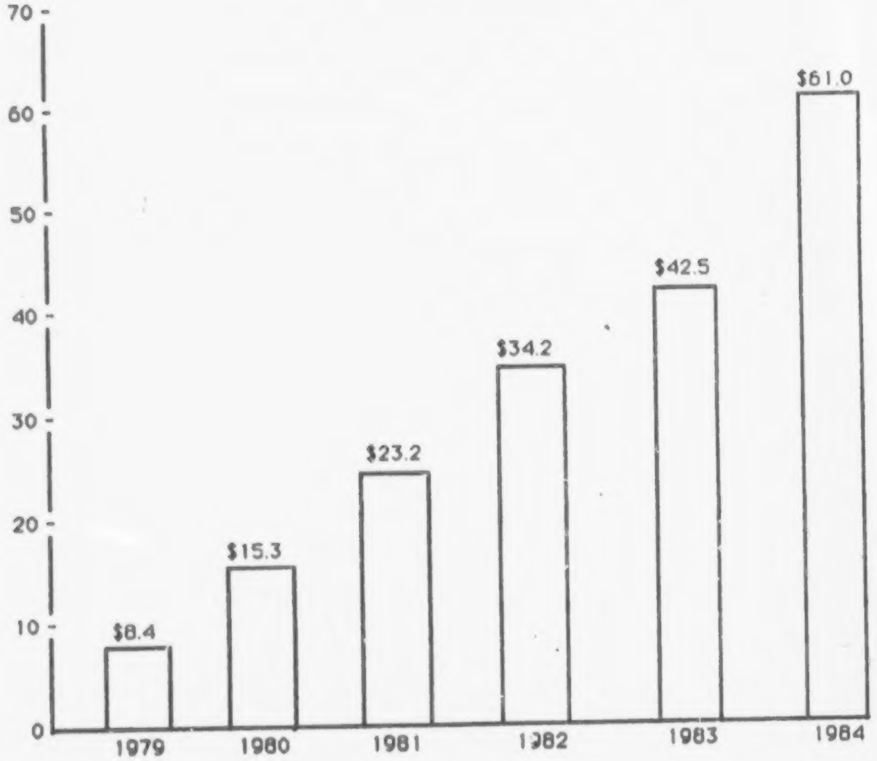

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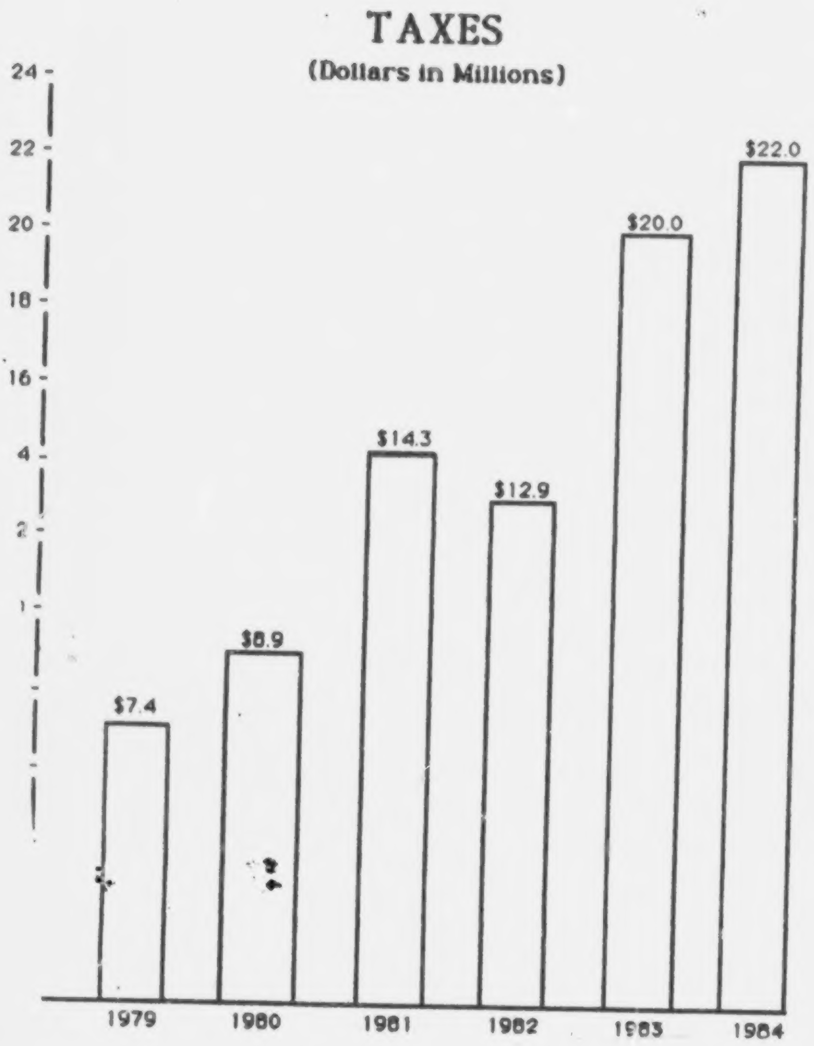

JOHN F. CARLSON

Title:	Executive Vice President and Chief Financial Officer
Birth Date:	November 23, 1938
Education:	B.S. in Business Administration, St. Mary's College, 1960 C.P.A., State of Minnesota, 1967

At Cray Research:

1976-Mr. Carlson joined Cray as Director of Finance
1977-Mr. Carlson became Treasurer
1978-He became Vice President of Finance and Chief Financial Officer
1981-He became Senior Vice President
1982-He became Executive Vice President

Previously:

1964-1976 - Mr. Carlson was employed by Peat, Marwick, Mitchell & Co., certified public accountants.

His community and industry affiliations include the following:

Board member, Norwest Bank of St. Paul
Board member, Junior Achievement
Board member, St. Mary's Hospital
Member, American Institute of Certified Public Accountants
Member, Minnesota Society of Certified Public Accountants

The CHAIRMAN. Mr. Carlson, thank you very much.

What I would like to do is give the other panelists a chance to read their statements and then proceed with any questions that we might have.

Thank you very much for your testimony.

Mr. Joe Childs, president and general manager of Center Industries Corp. of Wichita, KS. I gather, Mr. Childs, you are here with Mr. John Jonas, founder and president of Cerebral Palsy Research Foundation of Kansas.

Mr. CHILDS. That is correct.

The CHAIRMAN. Gentlemen, you may proceed in any way that you wish.

STATEMENT OF JOHN F. JONAS, JR., FOUNDER AND PRESIDENT, CEREBRAL PALSY RESEARCH FOUNDATION OF KANSAS, INC., AND JOE L. CHILDS, PRESIDENT AND GENERAL MANAGER, CENTER INDUSTRIES CORP., WICHITA, KS

Mr. JONAS. Mr. Chairman, we thank you for the opportunity to testify today in behalf of the handicapped assistance loan program of SBA.

My background has been in rehabilitation for some 30 years, many years with the Institute of Orthopedics where we dealt with a number of disabled individuals. In spite of all the therapies and the physical education programs that were brought forward to assist them, when they reached the age of 18 or 19, young adulthood, there was no place for them to go, particularly to find employment.

We heard about a program in Australia that has a unique concept where they mixed able-bodied with severely disabled individuals and brought in the aspects of rehabilitation engineering to adapt and modify machines so that they could perform at near normal rates.

We brought this idea back to Kansas, approached the State legislature, received some response from them. We wanted very much to develop an ongoing industry that had some concepts related to ongoing industry rather than a sheltered workshop environment.

As you know, Senator, one of the greatest problems in the handicapped business today is the attitudinal barrier. We wanted very much not to be associated with the tin cup approach, as some of the less interesting jobs that are often associated with this population.

We developed certain standards: One, that the industry would pay minimum wage or better. Two, that the industry would pay full health benefits. As you know, many severely disabled individuals are on Medicare or Medicaid. Three, that no charitable funds would go into the industry. Four, that the handicapped employees in the industry would not be mentioned in the brochure, that our strength would come from rigid quality control, timely delivery, and competitive pricing—in other words, recognizing the disciplines of real business.

In order to emulate ongoing industry, it was necessary to go into an industrial park area. We looked to SBA for assistance. We did request—and it was approved—$350,000 for a HAL loan. We tied that money in with some vocational rehab funding, an $85,000 appropriation from the legislature with a promise from the State legislature that, if we were successful in developing the industry, we could have the tag contract, manufacturing license plates for Kansas.

We also made an association with the College of Engineering at Wichita State University, which allowed us to develop the rehab engineering concept that was so vital to this industry.

You asked for the facts. I would like to just simply state that we went back 5 years. In addendum 1 to the written statement, we show in those 5 years we paid out $3,696,729 in wages. Eighty percent of the employees are severely disabled. Income taxes paid by these employees was $497,250. State income tax was $85,827. Social Security tax was $236,722, for a total of $819,800 in taxes paid out by people that normally would be taking from the Government rather than giving. We also paid out $323,541 in Blue Cross/Blue Shield payments.

Probably the thing that we are most proud of is that our employees contributed $14,458 to United Way. Instead of taking funds from United Way, we contributed.

This is an interesting concept because, when you look at the total impact, it is almost double in a positive way because the cost of not providing these kinds of jobs for this particular population is very high, as you all know.

I would like to have my colleague, Joe Childs, president of the center, talk about the contracts that we have. We have had four major HAL loans during the past 7 years, and he will recount those loans.

The CHAIRMAN. Thank you very much, Mr. Jonas.

Mr. Childs.

Mr. CHILDS. Mr. Chairman, the Center Industries concept I think has been manyfold. One of the biggest factors we have had is a good private industry relationship. Our contracts have multiplied with companies such as Boeing Military Airplane Co., American Telephone and Telegraph, National Cash Register Co. We are doing farm tools for the farm industry selling to John Deere and International Harvester.

As Mr. Jonas mentioned, we are doing this using 80 percent severely disabled individuals. The beautiful thing about it is that the center's concept started with the HAL loan, with 20,000 square feet. Getting the confidence of the banking industry in our city was impossible. The HAL loan was the only way we could start.

The CHAIRMAN. Mr. Childs, would you, just for the benefit of those here in the room and those who are watching, tell us what a HAL loan is?

Mr. CHILDS. OK. The HAL loan—we were approved in 1974—is a handicapped assistance loan. The maximum at that time was $350,000. Our particular fringe to that was that it was at a rate of 3 percent. We think that basically we paid that down below $200,000 and borrowed back. The 3 percent loan was very attractive to us from the standpoint of the indebtedness. The biggest thing that I think helped us was that it was a 15-year loan. All the local banks would go 6 or 7 years at the most. So we were able to amortize that loan in the early years at about $2,500 a month. We have been current for the 9½ years and have never faltered on any of our participation loans.

The HAL loan was the key with the 20,000 square feet. We are now 78,000 square feet. We developed the confidence of industry. We have these major industries now bringing in their equipment, bringing in their inventory. We furnish labor, and their investment in us totals over $1.5 million. This is Boeing, AT&T, NCR, and other companies.

We think the big plus to that is the fact that we are educating them on what the handicapped population can do. We think it is beautiful to bring private industry into our facilities and show them what the matching of engineering and the comingling of the handicapped with able-bodied employees can do.

Our average wage is $4.36. Our total fringe program for that disabled individual is $1.42. We contribute tremendously to the community in taxes, and it is a definitely a doubled-edged sword. We are able to really compensate for people who otherwise would not be employed.

I think that concept needs to move on outside of the State of Kansas. That is the area that Mr. Jonas can further address.

Mr. JONAS. At the time we went to Australia, Senator, in 1972 that same company was visited by a delegation from Japan. We came back and we developed Center Industries. Every State in the country has come to our facility. They would like to replicate what we are doing. We have done it the hard way; there is no question about it.

Rehab funds from SBA are no longer available for startup and staffing. We would like very much to request of SBA to form an ad hoc committee that would allow the possibility of studying the expansion of this program. Maybe that is a horrible word today when we are talking about SBA, but within the confines of the funds already directed to that program there might be some spinoff.

I referenced Japan because today there are 250 model industries similar to ours in Japan employing thousands of people. They were able to achieve this by developing a working relationship with the private-public sector. We have to do this to achieve the employment of the severely handicapped.

I know of your sensitive efforts, Senator Weicker, particularly in the area of special education. I have seen you plead for the special education funds, and I know how important these are.

Only 21 percent of the people graduating from special education are attaining full employment. There are four primary employment systems for the disabled, as you well know: Vocational rehabilitation, projects with industry as part of that, sheltered workshops, and ongoing industry.

We are not putting any of these programs down; they are all viable, but we think that there needs to be an additional concept similar to what Center Industries has to move these programs forward and employ more people.

We think the timing is pretty good at this time because just a few weeks ago, as you may be aware, the White House announced a private sector initiative requesting assistance from the aerospace industries to tie in with their technology to develop elaborate systems to maintain the severely physically limited people on this

Earth with the expertise that they have utilized in space. That initiative was made through Jack Pierce, treasurer of Boeing, out of Seattle. We have been asked to participate in that.

There might be some way this ad hoc committee can tie some of these linkages together to move some of these programs forward.

We have, there is no question about it, with the application of the rehabilitation engineering, the application of sound business practices, many severely functionally limited people that were traditionally written off for employment who can be engaged in active employment in a very dignified way, and I would like to outline the word "dignified."

Thank you, Senator.

[The prepared statement of Mr. Jonas and Mr. Childs follows:]

Respectfully Submitted to the
United States Senate
Committee on Small Business

ON

S. 408, a bill to authorize and provide program levels
for the Small Business Administration (SBA)
for Fiscal Years 1986, 1987, and 1988

BY

John F. Jonas, Jr.
Founder and President
CEREBRAL PALSY RESEARCH FOUNDATION OF KANSAS, INC.

and

Joe L. Childs
President and General Manager
Center Industries Corporation

February 19, 1985

February 19, 1985

The Honorable Lowell Weicker, Jr., Chairman, U.S. Senate Committee
on Small Business

We thank you for the opportunity to testify today before the Senate Committee on Small Business in support of the Handicapped Assistance Loan (HAL) program of SBA.

Mr. Joe Childs has been President and General Manager of Center Industries Corporation (CIC) for the past eight years. Prior to that time, Mr. Childs was a volunteer on the Cerebral Palsy Research Foundation of Kansas (CPR) Board and Vice President of a manufacturing firm in Kansas.

As President of CPR and Founder of Center Industries Corporation which is a subsidary of CPR, I would like to state that the $350,000 SBA HAL Loan Program, approved in August 1974, acted as a cornerstone funding base in the development of this unique industry. Approximately $1 million was required to provide the necessary capital for land, buildings, and operational budget to launch this industry designed to employ severely physically persons in a dignified mainstream industrial environment. Although Center Industries Corporation is under a 501(c)(3) not for profit organization, every attempt has been made to emulate a mainstream industry rather than a sheltered workshop environment. Some twelve years ago I had an opportunity to visit a unique program in Sydney, Australia,called Center Industries, and its founder, Mr. Neil McLeod. In addition to the Centre emulating mainstream industry, Mr. McLeod brought together for the first time the concept of rehabilitation engineering support in the modification of work stations, machines, and hand tools to increase the productivity of the severely physically limited people. I was quite interested in this approach as far a number of years I had worked as a speech pathologist and audiologist at the Institute of Logopedics which had a great number of severely disabled cerebral palsied children and adults. The simple truth was that in spite of the elaborate therapy and special education programs, when these youngsters reached the age of 20 or 21, they were sent home or to a nursing home, or some other submarginal environment to waste the balance of their lives.

About this same time, a professional relationship was developed with the College of Engineering at Wichita State University. The University pledged its support in exploring this new concept of applied rehabilitation engineering to advance the employment potential of the severely physically limited individuals. In order to generate interest in the United States and, in particular, Kansas, we brought from Australia a film outlining the concept showing a mix of 600 able-bodied and severely disabled employees working side by side producing sophisticated telecommunication components. This film was shown literally hundreds of times in Kansas and gained the attention of some key persons in the State Legislature resulting in the Legislature appropriating an amount of $85,000 to assist in the development of start-up cost for Center Industries in Wichita.

In addition, the Legislature tentatively approved the manufacturing of the State's automobile tags at this new industry with the understanding that equipment would be made available by the State. It was at this particular time that I learned of the availability of the HAL Loan Program under SBA. The loan was approved in August 1974. In addition, a $200,000 Vocational Rehabilitation construction grant was awarded and the $85,000 originally granted by the Legislature was matched (20/80%) with the State Vocational Rehabilitation Services to provide staffing and equipment funds. It is important to note that Vocational Rehabilitation no longer provides this assistance. The $350,000 HAL loan provided $268,200 towards cost of land and building and $81,800 for operational start-up funds.

For the concept of Center Industries to work, it is absolutely necessary to emulate mainstream industry rather than a sheltered workshop environment. Therefore, special consideration was given to a site located in an industrial park. The greatest challenge was overcoming the attitudinal barrier which often equates the "tin cup" approach with so called meaningful jobs for handicapped people. Certain standards applied:

1. Center Industries would pay minimum wage or above to all workers.
2. The industry would provide a full range of health and dental insurance to offset the Medicaid payments that would be lost by severely handicapped individuals earning minimum wage or more.
3. No charitable funds could be contributed to Center Industries as it was a business, not a charity.
4. The handicapped employees would not be mentioned in the industry's brochure, the program would be sold on rigid quality control, timely delivery, and competitive pricing of products.

Recognized business disciplines would be enforced.

The support services, such as transportation, housing, attendant care, recreation, therapeutic services and counseling, etc., were provided by the parent organization at a different location in Wichita.

Center Industries Fact Sheet

A review of the total wages and taxes paid during the past five years from calendar year 1980 through 1984, is outlined in Addendum 1. The summary shows that total wages over five years is an amourt of $3,696,729. Federal income taxes paid by employees were $497,250. State income taxes paid by employees were $85,827. Social Security paid by employees were $236,722 for a total of $819,800.

Five major contractors of Center Industries include the Boeing Company, the State of Kansas, NCR, S/V Tool and AT&T. CIC provides for Boeing the passenger windows for commercial airliners and performs dip soldering of electronic components used in the avionics equipment of military aircraft. The State of Kansas is supplied all its metal auto tags, validation stickers, and truck decals and NCR is provided with several types of computer wiring harnesses. S/V Tool includes a selection of proprietary small farm tools for John Deere, International Harvester, and similar farm equipment manufacturers. AT&T is a customer for small connector assemblies used for testing printed circuitry in telephone systems. CIC also deals with approximately 25 smaller businesses.

There are currently 112 employees at Center Industries Corporation, approximately 80% of whom are disabled. Annual sales for 1985 is projected at $2 million. Addendum 2 indicates that the private sector investment of facility, equipment, and inventory is estimated at $1½ million.

In addition to the original HAL loan of $350,000, there have been four other HAL loans negotiated by CIC and SBA. Two were direct loans, one for $55,000, another for $70,000 for purposes of expansion. There were also two guaranteed loans, one in the amount of $175,000 and another for $220,000 at 37% guaranty under SBA. These loans assisted with four major plant expansion programs over the past nine years, Addendum 3.

Through the entire history of expansion of Center Industries, the SBA HAL Loan Program continues to play a significant role.

It is stated in the first paragraph of the invitational letter to participate in today's hearings "that at this time the Committee will carefully evaluate all SBA programs with an eye toward meaningful reforms and cost savings in order to report a multi year authorization bill".

It is highly doubtful that Center Industries could have achieved the success of today without the availability of the HAL SBA participation loan program. Although the Administration calls for the termination of SBA, perhaps noting political realities as they are, it is hoped that some areas of reorganization might be explored to focus a greater concentration on the needs of handicapped people than has been possible through SBA. I feel there is a window of opportunity that exist this very day that did not exist as early as one month ago. This is simply the premise that, if severely physically limited people can be employed in a working environment of dignity in Wichita, Kansas, the same opportunity can and should be made available in every major community throughout the United States. Over the past ten years, we have been visited by literally thousands of individuals form the United States and overseas requesting our counsel and assistance in developing similar programs in their respective countries, states and communities. From the brief description of the birth of Center Industries, you will note that this is an extremely complex effort to replicate. We did it the hard way, there is a need to develop a plan for reasonable replication.

The Honorable Chairman knows all too well the needs of severely handicapped people. His devotion to the Special Education mandate, the Developmental Disabilities program, to Vocational Rehabilitation are a matter of record. In Kansas, we initiated the Special Education mandate two years before the Federal mandate was required. We support these activities. The sad truth reported by the President's Committee on Employment of the Handicapped is that each year approximately 650,000 handicapped people either graduate from high school or become too old to qualify for public education. Only 21% will become fully employed. Forty percent will be underemployed and at the poverty level and 26% will be on Welfare. The annual cost of Special Education in the United States is approximately $35 billion. In Kansas alone, a total of approximately $130 million is spent every year on Special Education. Further, in Kansas, it is estimated that $1.5 million is expended to maintain one severely disabled individual in a submarginal environment over a normal lifetime.

Currently, there are four major employment programs that are attempting to address the employment requirements of disabled people. They include Vocational Rehabilitation, Projects with Industry, Sheltered Workshops, and general employment. Although there are other supporting programs such as tax job credits, the four indicated above are the primary systems engaged in the delivery of employment opportunities for

for this population. This is not an attempt to discredit these programs; however, if only 21% of the graduating Special Education young adults can find employment, it is obvious that we must deliver some new, innovative programs in conjunction with those currently in existence to improve the opportunity for meaningful employment for this population.

In 1972, when I visited Centre Industries in Australia, a delegation of officials from Japan also made a visit. They also liked what they saw. They went home and formed a partnership between the private sector and public sector to emulate the Centre Industries approach in Japan. Today, there are 250 model industries in Japan, employing thousands of severely handicapped people. Although they are for-profit corporations, the Government subsidizes, through low interest loans, approximately 70% of the capital required to start and maintain these industries. The industries have to agree that at least 50% of their employees will be handicapped.

In spite of the hundreds of visitors that have toured Center Industries and other programs of the Cerebral Palsy Research Foundation of Kansas, we still remain the only Center embracing this concept in the United States. The main reason is that the U.S. has not developed a public/private sector partnership that the Japanese had the insight to do some ten years ago. Note addendum 4.

On January 3 of this year, the White House announced formally a public/private sector initiative related to technology for the disabled. Note Addendum 5. This letter was accompanied by a video tape made by the Boeing Company which includes statements by President Reagan, James

Biggs, Administrator of NASA, Casper Weinberger, Secretary of Defense, and Margaret Heckler, Secretary of Health and Human Services, asking 50 CEO's of major aerospace industries to support an innovative effort to improve the quality of life for some 35,000,000 severely physically handicapped Americans.

The rationale is that if the aerospace industries can successfully place an able-bodied man in a foreign environment in space, that similar achievements should be possible in assisting severely physically limited people to be productive on earth. Mr. Jack Pierce, the Treasurer of the Boeing Company, is the pioneer of this effort. He has asked me and my colleagues to help him in the initial phase of launching this program, which we are pleased to support.

Our primary proposal for you today is to encourage the formation of an Ad Hoc Committee that can work with us in encouraging the SBA to take an even greater role in the advancement of the Center Industries concept to employ severely handicapped persons. It is suggested that a pilot project be created that would develop ten industries within the next three years.

That the discussion of support from SBA in assisting these industries include the following:

1. To expand the HAL Loan Program to $1 million rather than the $350,000 limit existing today.
2. Develop a working relationship with these ten pilot projects on a government set-aside contract basis with some aspects similar to the 8(a) program. One consideration would permit these industries to have a 15% net profit margin until the HAL loan was paid in full.

Another concept relative to political expediency may be to require the proposed industries to subcontract perhaps 25% of work to minority and other small businesses.

3. Develop incentives for mainstream industry to participate, i.e., (tax credits and/or contractual incentives) in contracting with the ten centers. As you are aware, currently $100 million in contracts are utilized primarily because (it is my understanding) these contracts have to be rebid each year and longevity is not in any way assured.
4. That linkages be developed with the private sector initiative by aerospace industries that could assist in the contractual and engineering support services for these facilities.

It is understood that these facilities will not be sheltered workshops!

1. That the providers of these facilities would have to emulate mainstream industry rather than a sheltered workshop environment.
2. That the provider would have to pay minimum wage or better.
3. The provider would provide a comprehensive medical insurance program to offset the loss of Medicare/Medicaid.
4. The employment ratio could be as high as 50% able-boided and/or disabled, or any combination.
5. The provider shall target employment opportunities for the very severely disabled, i.e., those individuals that are usually found non-feasible for employment by Vocational Rehabilitation and/or PWI programs.
6. The emulation of mainstream industry would include the detachment of the charitable image.

7. That the management skills would be based on industrial professionality rather than the social background.

Candidly speaking, a Legislative Assistant to Senator Dole, approached some of the higher administrative officials in SBA approximately one year ago to encourage the consideration of support of a pilot project for handicapped individuals, similar to what is outlined in this proposal. She was told that this was not the primary mission of SBA and was offered little encouragement. We are, of course, hopeful that in lieu of the current status of SBA, that these officials may be willing to rethink their position regarding this proposal.

We will be pleased to provide you with any additional information upon request.

We would like to summarize by simply stating that for the past ten years, Center Industries has proven a concept that is both morally and economically sound. Unlike Japan, however, we have been unable, up until this time, to develop a working formula between the private and public sectors to have this program emulated throughout the United States. It is time we get on with the effort. We stand ready to offer whatever assistance we can.

Thank you for the opportunity of being here today.

Addendum 1

CENTER INDUSTRIES CORPORATION
WICHITA, KANSAS

TOTAL WAGES AND TAXES PAID

	CALENDAR YEAR 1980	CALENDAR YEAR 1981	CALENDAR YEAR 1982	CALENDAR YEAR 1983	CALENDAR YEAR 1984	FIVE YEAR TOTALS	ESTIMATED CALENDAR YEAR 1985
TOTAL WAGES	$636,099.09	$651,326.78	$713,460.29	$762,963.65	$932,879.90	$3,696,729.71	$1,292,646.02
FEDERAL INCOME TAXES PAID BY EMPLOYEES	$84,068.65	$92,523.80	$100,823.55	$101,576.20	$118,257.85	$497,250.05	$161,256.00
STATE INCOME TAXES PAID BY EMPLOYEES	8,194.90	14,521.10	18,192.85	20,532.70	24,386.00	85,827.55	34,398.00
SOCIAL SECURITY TAXES PAID BY EMPLOYEES	38,182.84	41,788.88	46,285.59	49,557.19	60,908.45	236,722.95	91,148.04
TOTAL	$130,446.39	$148,833.78	$165,301.99	$171,666.09	$203,552.30	$819,800.55	$286,800.04
MEDICAL -							
Group Hospitalization Premiums Previously paid By the Government on 75% (SSI, Medicare, etc.)	$48,514	$ 59,275	$ 60,384	$ 66,907	$ 88,461	$323,541	$ 92,000
UNITED WAY Contributions	$ 2,272	$ 2,382	$ 2,976	$ 3,065	$ 3,863	$ 14,558	$ 4,200

Addendum 2

CENTER INDUSTRIES CORPORATION

WICHITA, KANSAS

CUSTOMER (PRIVATE SECTOR) INVESTMENT

February, 1985

	INVESTMENT	EQUIPMENT LOANED	INVENTORY
BOEING			
Glass Shop Room	$ 124,600.	$ 35,000.	$ 200,000.
Tinning	52,000.	20,000.	100,000.
Shrink Wrap		10,000.	2,000.
Rubber Extruded Parts		5,000.	10,000.
Nut Plate Assemblies		1,000.	20,000.
STATE			
License Plates	$ 220,000.	$ 75,000.	$ 125,000.
Validation Stickers	52,000.		50,000.
SMITH TOOL			
Farm Tool		$ 20,000.	$ 2,000.
A T & T			
Connectors		$ 65,000.	$ 100,000.
N C R			
Wire Harness		$ 10,000.	$ 25,000.
Computer		10,000.	
ESTIMATED INVESTMENT	$ 500,000.	$1,000,000.	

Addendum 3

CENTER INDUSTRIES CORPORATION

WICHITA, KANSAS

HISTORY OF SBA LOANS

	DATE	AMOUNT	BALANCE	STATUS	USE OF LOAN	TERM	MATCHING	EMPLOYMENT
#HAL1-677140-10-04-W Direct H.A.L. Loan	9/10/74	$350,000.	$224,563.	Current	Land & Building	15 yr.	40% State Vocational Rehabilitaton	23
Paid Down To: $284,445 Borrowed Additional	3/13/79	$ 55,000.	Above	Current	Equipment	Same	None	
#HAL-1 (GP) 208888-20-01-W Bank Participation Loan	2/20/79	$175,000.	$136,417.	Current	Land & Building	15 yr. Amortizaton (9½ yr. Ballon)	$75,000 Community Block Grant	52
#867344-11-3 Direct Loan	4/03/81	$ 12,000.	$ 1,582.	Current	Tooling	6 yr.	None	
#HAL-1-139812-30-04W Direct H.A.L. Loan	8/13/82	$ 70,000.	$ 54,960.	Current	Equipment - Validation Stickers	10 yr.	Commercial $90,000.	58
#HAL-1 (GP) 209122-30-10-W Bank Participation Loan SBA 37% Guarantor	Feb. '85	$220,000.	-	Under Construction	Building	15 yr.	50% Department of Health & Human Services - Office of Community Services Award #UR0118	112

Addendum 4

AN ALTERNATIVE EMPLOYMENT MODEL FOR HANDICAPPED PERSONS*

Dong W. Cho

Wichita State University

*Presented at the 14th Annual Conference of the Ontario Rehabilitation Workshop Council, Honey Harbour, Canada, June 2, 1983

AN ALTERNATE EMPLOYMENT MODEL FOR HANDICAPPED PERSONS

I will discuss a particular employment and training model for handicapped persons recently developed in Australia, United States, and Japan.[1] I will first discuss some detail of the examples of this employment model. When I discuss the Australian and U.S. cases, I will not discuss the overall rehabilitation systems and public policies of these countries. But I will comment on certain aspects of the Japanese systems and policies because some of them are relevant to the discussion of this employment model. After describing the examples, I will summarize the economic behavior of the organizations under this model. Finally, I will present broad implications of this model to workshops today.

Before I start, I must say that what I will discuss is the work of innovative persons in the field of rehabilitation like Mr. Neil McLeod of Sydney, Australia, Mr. Jack Jonas of Wichita, Kansas, and Mr. Takeo Noda of Japan. I simply try to describe and conceptualize their work and communicate these to others interested in this important employment policy area.

The employment model that I will discuss is a variation of the extended employment workshop, and is located somewhere between traditional workshops and mainstream employment. In most countries with a well established rehabilitation system, employment opportunities for handicapped persons are usually found in either mainstream industries or sheltered workshops. Employment in mainstream industries has usually been confined to mildly handicapped persons because mainstream industries lack the rehabilitation facilities and expertise to cope with the needs of a severely handicapped person. On the other hand the economic progress of handicapped persons under sheltered employment has been modest. Futhermore, the transition from sheltered to mainstream employment has not been easy. Therefore, there has been a need for an alternate employment and training arrangement that may close the gap between sheltered and mainstream employment. The employment model that I want to discuss can be viewed as an attempt to close this gap. Before getting into details, if you asked me what is the most distinctive feature of this employment model, I would respond that the production workforce has a more balanced mix of handicapped and nonhandicapped persons.

CENTRE INDUSTRIES, SYDNEY, AUSTRALIA

The story of this experimental employment model is the story of Centre Industries in Sydney, Australia, or, more specifically, the story of Mr. Neil McLeod. In 1945, a group of parents of cerebral palsied children founded the Spastic Center of New South Wales under the leadership of Mr. McLeod. Since then, the center has provided comprehensive, family oriented services to spastic children; ranging from medical care, transport services, therapy, and education and training. In 1961, the Spastic Center formed a workshop to provide training and jobs to cerebral palsied youth who completed their education at the Centre. The workshop was named Centre Industries. Centre Industries entered the telecommunication equipment business. Today, the company manufactures communication equipment such as telephone exchange relay sets and electronic teleprinters for the Australian telecommunication industry and market. The company also produces traffic control equipment and semiconductor materials. The company's business expanded when the company entered a subcontract agreement with a French electronic firm and manufactured electronic teleprinters for an Australian telecommunication company. The company has technical assistance agreements with several oversea companies such as General Electric Company and General Telephone & Electronics of the United States, SAGEM of France, and

Fujistu of Japan.

By 1979 Company sales reached 6.4 million in Australian dollars and the production goal reached 10 million in Australian dollars in 1982. The 1982 production target corresponds to about 9 million U.S. dollars at the current rate of exchange. The company, as described, sounds very much like a currently fashionable "high tech" company. However, one big difference exists. That is (i) the company employs a substantial number of disabled persons who are unable to get regular jobs in the normal industrial environment and (ii) the company engages in significant levels of rehabilitation activities. For example, in 1979 the company employed 640 workers. About 300 of them were handicapped and 340 were able-bodied workers. Most handicapped employees had a severe form of cerebral palsy. (In preparing this presentation, I wrote to Mr. McLeod and asked him what the current situation is. He said the recent world wide recession reduced the business order and the number of handicapped employees is 282 and the number of able-bodied employees is 307.)

The presence of a large number of severely handicapped persons in the workforce increases costs becuase of the need to provide evaluation, training, rehabilitation staffs, extra floor space, extra equipment, and machine adaptations and modifications. This extra costs or rehabilitation costs are substantial and were estimated to be 1.3 million in Australian dollars in 1979. This extra cost cannot be charged as a production cost and passed foward to customers, because that means either too high prices or too low qualities for its products to compete in the open market. Centre Industries developed an accounting procedure that estimates this cost as a separate item. Then these costs are financed from government subsidies, private contributions, and the company's profits. Under the Australian system government subsidies cover about

80 percent of these rehabiliation costs.

In the midst of these business activities, the organization never lost sight of its rehabilitation mission. The main emphasis of Centre Industries in rehabilitation has been application of engineering solutions to the problems of its disabled workers within a normal working environment. It is no accident that the company is in a high technology field. The industrial technical expertise of the company has been applied to rehabilitation of its disabled employees. Currently, Mr. McLeod has a high hope that microcomputers will provide a means of improving the communication ability and the living environment of persons with cerebral palsy.

CENTER INDUSTRIES CORPORATION OF WICHITA, KANSAS

Centre Industries has been very successful as both a rehabilitation organization and a business organization. What Centre Industries has demonstrated is (i) handicapped and nonhandicapped persons can work together in production and (ii) rehabilitation interests and commercial interests can be complementary. Its success has drawn the attention of the rehabilitation community of the world. It also attracted the attention of enterprising souls in rehabilitation who were interested in developing a similar employment and training system elsewhere. One such individual is Mr. Jack Jonas of Wichita, Kansas. In 1975, Mr. Jonas established Center Industries Corporation with a 350,000 dollar loan from the Small Business Administration. Initially, Center Industries Corporation manufactured automobile licenses plates under a contract with the State of Kansas. Since then it has gotten into other direct manufacturing and business contracts with local industrial firms such as Boeing Airplane Company. Currently, the company hires 48 handicapped and 20 nonhandicapped persons. The annual sales is about 1.7 million dollars. One thing to note about Center Industries of Wichita is that all handicapped persons have been paid at least the minimum wage level. The current statutory minimum wage level is $3.35 an hour, and the average hourly rate of handicapped workers is $4.19. This may be an indication of the Center Industries' determination to get out of the mold of sheltered workshops and to get into the mold of regular business. However, this has been possible partly due to the company's efforts to improve the productivity of handicapped workers through machine adaptations and work site modifications, with the help of the Rehabilitation Engineering Center of Wichita State University.

JAPANESE MODEL FACTORY SYSTEM

Another enterprising individual is Mr. Noda of Japan. Mr. Noda is the head of a consulting firm specializing in the employment of handicapped persons. Japan is one of few countries that has developed a comprehensive rehabilitation and social services programs for their handicapped populations. Japan's growing economy has made the sustained growth in resources for handicapped persons possible. One characteristic of the Japanese rehabilitation program is strong vocational orientation. Part of this undoubtedly reflects Japanese work ethics. However, it seems that they believe, from the society's standpoint, that the economic benefits of work by handicapped persons far outweigh the economic costs of providing employment to handicapped persons. They seem not much interested in confirming this proposition. They simply accept it as a truism. In fact, when unmeasurable indirect benefits are added, it is difficult to visualize the situation where the social benefits of employment of handicapped persons are less than the social costs, even if persons are severely handicapped.

Mr. Noda organized several trips to Australia for Japanese rehabilitation personnels and handicapped persons. After several visits to Centre Industries, he helped develop an employment arrangement called "Model Factory". The Model Factory system consists of a number of small private businesses employing a large number of handicapped persons. By 1979 there were 60 model factories operating mainly in light manufacturing industries. Briefly, here is how they work:

Small businesses or more business-minded workshops apply to the government for a model factory designation. If both the business plan and the plans to accomodate handicapped workers are approved, government provides the business with a low interest loan up to 100 million yen, which is about 430,000 dollars at the current rate of exchange. The conditions of the loan is that at least 50 percent of employees, exclusive of executives, must be handicapped persons and the loan must be used only for the acquision of capital assests and must not be used to cover operating expenses. A survey of 10 model factories taken in 1977 shows that the average annual interest rate for this loan was 5.6 percent. This low cost loan has been very important in establishing model factories. The same survey shows that about 70 percent of model factories' capital assets were financed through these loans. The government plan at that time was to expand the number of model factories by 25 each year for the next five years. (I do not have an update on this. If things worked out as planned, there should be more than 150 model factories by now.) A sample survey of 10 model factories shows that the average number of employees was 67, of which 56 percent were handicapped. The average annual earnings was about one million yen for physically handicapped employees. That is about 4,300 dollars per year. The average earnings for mentally handicapped persons was about two-thirds of that of physically handicapped workers, and the average for nonhandicapped employees was about 30 percent higher than that.

The earnings of handicapped workers in model factories are substantially higher than the earnings of handicapped persons in the Japanese workshops. For example, the average earnings of handicapped workers in sheltered workshops was about 1,300 dollars, or about one-third of the earnings of physically handicapped model factory workers. Roughly, the earnings of a worker reflects the productivity of the worker. The productivity of handicapped persons in model factory is much higher than that of handicapped persons in workshops, primarily because government capital subsidies enabled model factories to purchase and utilize more productive, automated machines. (No comparisons are available, but I suspect that the capitalization of model factories is better than that of comparable size small businesses in Japan.) Also, the mix of handicapped and nonhandicapped workers expanded the opportunity of division of labor compared to work procedure where most workers are handicapped. This also helps increase worker productivity. Model factories tend to employ less severely vocational handicapped persons than do sheltered workshops. However, one interesting feature of the Japanses law governing employment of handicapped persons is that employing one severely handicapped person is equivalent to employing two mildly handicapped persons. Thus, there are some incentives to hire severely handicapped persons.

One major difference between Japanese model factories and Centre Industries in Australia and Wichita is that model factories are for-profit private enterprises, whereas Centre Industries are owned by nonprofit organizations. Come to think of it, this is a radical departure from the tradition of rehabilitation. Being a for-profit business, a model factory can distribute profits, if any, to owners and directors of the company. So, the owners and directors may get financial benefits by employing handicapped persons. This may appear to be an unscrupulous use of funds generated by handicapped workers. However, this may not be different from the practice of mainstream industries, which also hire handicapped and disadvantaged individuals and distribute profits to the owners. The difference is simply the size of the proportion of handicapped persons in the workforce. Still, this explicit business approach may go against the grain of the Western rehabilitation tradition which values services, giving, and humanism rather than profits and incentives. To understand why this system is well accepted in Japan, we have to go back to the Japanese rehabilitation system and the Japanese cultural tradition.

THE JAPANESE QUOTA-LEVY-GRANT SYSTEM

Perhaps, businesses are more trusted in Japan than they are in other societies. This is a reasonable assumption to make because basically relationships among businesses, workers, consumers, and government are nonconfrontational in Japan. However, more important is the Japanese system of employment quota for handicapped persons. Let me discuss this quota system because I believe this has been a factor in the development of an employment arrangement like model factory. The quota system itself has interesting implications in the efficiency in resource allocation in rehabilitation.

In 1960, Japan established voluntary employment quotas for handicapped persons with the passage of the Physically Handicapped Persons Employment Promotion Law. In 1976, the law was amended to make the quota mandatory. The current employment quotas for physically handicapped persons are 1.8 percent for public agencies and 1.5 percent for private businesses. The quotas were set to reflect the proportion of physical handicapped persons in the Japanese labor force. The quotas were also set to reflect the differences in the types of work and work environments of individual industries. Thus, quotas are different from one industry to another. As mentioned earlier, to encourage the employment of severely handicapped persons, severely disabled persons are counted twice in fulfilling the quotas. This statutory quota system is applied only to physically handicapped persons and is not applied to mentally handicapped persons.

The law stipulates that large employers with more than 300 workers should pay 30,000 yen per month for every handicapped person short of their quotas. The levy is about 130 dollars in U.S. money. For example, a firm with 500 employees is required to hire about seven handicapped persons. If the firm hires no handicapped persons, the firm is required to pay about 900 dollars per month or about 11,000 dollars per year. I was told that most big industrial firms choose to pay the levy rather than to comply with the quotas. This seems to suggest that the levy is set too low for big businesses. The funds raised this way are used as cash grants to employers hiring handicapped workers in excess of their quotas and capital grants to new projects and ventures like model factories.

I think this quota-levy-grant system is a most effective way to increase the interests of businesses in employment of handicapped persons. This system does not simply deal with the social responsibility of businesses, but deals with incentives and monetary consequences. The system requests business resources and commitments in solving employment problems of handicapped persons. In this context, model factory may be considered as businesses' efforts to develop the expertise and experiences in hiring handicapped persons. It is no surprise that model factories are frequently a subsidiary of big corporations. Large companies have some incentives to establish model factories because handicapped workers in their model factories in excess of the 50 percent minimum requirement can be counted towards the parent companies' employment quotas. In the long run, experiences and innovations developed working with handicapped persons in a model factory arrangement may be transferred to the parent companies' production systems.

While this quota-levy-grant system places financial burdens on businesses, the system is designed to provide a significant flexibility to businesses. For example, companies can compare the levy with the extra costs of employing handicapped persons. Thus, companies that are efficient in employing handicapped persons will find that the costs are less than the levy and will hire handicapped persons. Companies that are inefficient will pay levy. In some cases, the payment of the levy may be an only alternative because of mismatch between employers and handicapped persons over geographic locations and occupations. The levy-grant system transfers resources from inefficient employers to efficient employers. The consequence is that a larger number of handicapped persons will be employed at the given amount of resources. Thus, the system tends to increase the economic efficiency in resource uses in rehabilitation.

CHARACTERISTICS AND ECONOMIC BEHAVIOR OF FIRMS UNDER THIS MODEL

Having described examples of this employment model, let me summarize some common characteristics in the economic behavior of the firms under this model. I would say the most distinct characteristic is a more balanced mix of handicapped and nonhandicapped workers in production. This characteristic presents major implications on the economic behavior of the firms under this employment model:

First, the balanced mix of able-bodied and handicapped persons in production allows more combinations and possibilities in designing the work process. This also allows for more meaningful division of labor among handicapped and nonhandicapped workers. The increased flexibilities and improved worker productivities help improve the productivity of the company. The increase in productivity holds the key to the success of the organizations in the product market. In short, the mix of handicapped and nonhandicapped workers is a productivity increase measure.

Second, handicapped persons are presumably a high cost employee. There are numerous examples where handicapped workers do not cost employers a dime in special costs. However, it is important to look at averages. On average, it costs more to hire handicapped persons than nonhandicapped persons. The extra costs of employing handicapped persons will increase the costs of the firm's product and lead to uncompetitive disadvantages in the market. This cost disadvantage is greater when the proportion of handicapped workers is higher. A more balanced mix of handicapped and nonhandicapped workers help reduce this cost burden. In short, the mix is a cost saving measure.

Third, while the main objective of workshops are to train and place handicapped persons in mainstream industries, this model attempts to provide permanent employment. That is, this is a training and employment model, rather than a training and placement model. The presence of a large number of nonhandicapped workers provide an atmosphere of regular industrial environment. Handicapped persons are treated as employees and workers rather than clients and trainees. In short, the mix provides more realistic industrial work environments.

Fourth, employers of this model should have enough business experiences to attract productive nonhandicapped persons. Nonhandicapped workers have a wider employment opportunities. They would not work for these firms unless wages and working conditions are comparable to the industry standard. Thus, these firms have to compete with other firms in the industry in recruiting nonhandicapped workers. In short, the mix forces them to behave like regular firms in the appropriate labor market.

I discussed the economic consequences of having a balanced mix of handicapped and nonhandicapped persons as if the balanced mix is something independent of the broad characteristic of the firms under this model. A broad description of these firms is "business orientation". These organizations are set out to be like business. In order to behave like a regular business and to compete in the product and employment markets, these firms have to increase the proportion of more productive nonhandicapped workers in the workforce.

Business orientation is a key work because I can most comprehensively and approriately describe this employment model with that word. Individuals in Centre Industries and model factories take pride in their business-like approach as if business orientation itself has value. I am not sure wheither a marriage between rehabilitation and business can work in most circumstances for the maximum benefits of handicapped persons. In the midst of all the business targets and impersonal economic realities, the interests of handicapped individuals may get lost.

NEW DIRECTION?

Thus, I would like to conclude my talk by examining whether this business approach is desirable in rehabilitation. That is, what are the benefits of this approach? But most of all, what are implications of this model to workshops today?

The most obvious benefit of greater involvement in business is that the organization can generate more revenues for rehabilitation. Work programs under traditional workshops usually do not generate enough income to cover all the workshop expenses. According to a survey of sheltered workshops in the United States, business income accounts for about 60 percent of all workshop income in 1972.[2] The rest comes from fees generated from training and evaluation, and from public and private subsidies. In the United States, government resources for social programs and programs for handicapped persons have been cut in recent years. The real dollar allocations for vocational rehabilitation programs has been declining for sometime.[3] Thus, the relative contributions of fee incomes and public subsidies will continue to decline. Private contributions account for about 20 percent of workshop incomes in the United States, and we cannot expect that private sector can make up all the reductions in public supports. Thus, increasing work program income through productivity improvement, marketing, and better management may be an only alternative in raising revenues for workshops. In other words, workshops may have to expand its business activities whether they like it or not. The need for increased business activities is not unique to workshops. Under the environment of declining public subsidies, the similar need arises to other nonprofit organizations such as schools, hospitals and museums. The theory of nonprofit organization predicts that these organizations tend to increase business activities in order to subsidize the activities that they regard of high value, facing declining public and private contributions.[4]

What this model shows us is that the business approach does not have to be a forced alternative. In fact, this approach can provide benefits other than monetary compensations to workshops. In a broad term, main benefits are accountability and managerial disciplines that workshops acquire as a result of contacts with the market. A success or failure of a business is immediately reflected in its income statements. Managers of business are accountable for their decisions, and it takes a great deal of discipline to run a business. Thus, it is not a bad idea to expose oneself to the market to see whether the market approves what one does. The market may not be able to tell us exactly the value of rehabilitation, but it can tell us quite a lot about how to operate workshops and the labor market can tell us a lot about the value of rehabilitation. An exposure to the market helps us get into shape. Disciplines learned through contacts with the market can be transferrable to the rehabilitation side of workshop operation.

In the broadest sense, this employment model is an infusion of entrepreneurship to workshop operation. Entrepreneurship, among other things, stands for innovation and risk taking, which is a valuable characteristic not only in business but also in rehabilitation. Although the employment model that I discussed may not be the best solution to workshops, we must value the innovative spirits and entrepreneurship that made this experimental model a success. So, the lesson is not in duplicating this employment model, but in adopting an entrepreneurial attitude and appropriate incentives to improve the current rehabilitation system and to develop better alternative systems to serve our handicapped populations.

NOTES

1. My previous research reports on this employment model are: "Economic Costs and Benefits of Private Gainful Employment of the Severely Handicapped", Journal of Rehabilitation, 46(3), July 1980, pp. 28-32, with A. Schuermann; "The Japanese Vocational Rehabilitation System and Policy", Proceedings of the 3rd Annual International Conference on Rehabilitation Engineering, Toronto, Canada, June 1980, pp. 303-6, with A. Schuermann; "An Employment Model of Severly Handicapped Persons: Centre Industries, Sydney, Australia", Journal of Rehabilitation Administration, 4(4), November 1980, pp. 157-64, with A. Schuermann; and "Japanese Model Factory Employment of Handicapped Persons: An Economic Evaluation", Evaluation Review, 5(4), August 1981, pp. 427-50.

2. U.S. Department of Labor, Employment Standard Administration, Sheltered Workshop Study, Vol. I, June 1977.

3. Vocational rehabilitation program expenditures adjusted for inflation were 634 million in 1967 dollars in Fiscal Year 1975. The expenditures for Fiscal Year 1980 were 489 million in 1967 dollars. See U.S. Department of Education, Annual Report of the Rehabilitation Services Administration to the President and the Congress, Fiscal Year 1980.

4. Estelle James, "How Nonprofits Grow: A Model", Journal of Policy Analysis and Management, 2(3), 1983, pp. 350-66.

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Addendum 5

CIV.

Stan Little

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Mal

THE WHITE HOUSE
WASHINGTON

JAN 3

Mr. Malcolm T. Stamper, President
The Boeing Company
7755 E. Marginal Way
Seattle, Washington 98108

Dear Mr. Stamper:

President Reagan has proclaimed the ten years, 1983-1992, as the Decade of the Disabled. The President's intention is to enhance the quality of life for individuals with disabilities, and expand their productive capacity in the work environment.

The Federal Government has a long-standing commitment to people with disabilities. Consistent with this commitment, we are now establishing a public-private sector initiative on Technology and the Disabled. Members of Congress, the Executive Branch, private corporations, the professional and academic community and outstanding individuals will be invited to participate in this initiative. We are extending our personal invitation for you to join this important and prestigious group which will serve to heighten the visibility of this important national effort. A video cassette is enclosed which fully explains this program.

The need for such a public-private sector initiative is apparent. A large part of the population, some estimated 35 million Americans, have physical, developmental, mental or emotional disabilities. The United States enjoys a highly advanced industrial base with technical, managerial and human resources which can be marshaled to improve the quality of life for these Americans. Yet, a significant gap exists between the development of technology and its application to the needs of people with disabling conditions. The purpose of our public-private sector initiative is to help bridge that gap.

Concepts for Independent Living, a 501(c)(3) qualified, private, tax-exempt organization has been selected to assist in the administration of this program. They will be contacting you in the near future.

Our combined personal commitment, as reflected in the video, is vital to the success of this initiative. Together, we can make a difference. As a leader in technology, you can improve the quality of life for millions of Americans with disabilities. We look forward to your participation in this exciting and challenging initiative during the Decade of the Disabled.

Sincerely,

James M Beggs
James M. Beggs
Administrator, NASA

Margaret M. Heckler
Margaret M. Heckler
Secretary of Health and Human Services

Caspar W. Weinberger
Secretary of Defense

January 14, 1985

Mr. Malcolm Stamper
President
The Boeing Company
7755 E. Marginal Way
Seattle, WA 98124

Dear Mr. Stamper:

Recently, you received a letter with a video cassette from the White House that was signed by Health and Human Services Secretary Margaret Heckler, Department of Defense Secretary Casper Weinberger and National Aeronautics and Space Administrator James Beggs.

Those communications urged you to join in a national Public-Private Sector Initiative to apply the expanding body of technology to improving the quality of life for the disabled - thereby making it possible for them to play a more active and productive role in society.

Concepts for Independent Living, a private, non-profit, 501(c)(3) corporation has been selected to assist in the coordination of this initiative. We now want to invite you to support this effort.

The initial phase of this program is the incremental development of a nationwide communications network (TECHNET) to provide ready information on assistance, motivation, employment opportunity, recreation, training and other services to the disabled community. Concurrent with this task, we will be organizing a program of technical teams (TECH-TEAMS) to operate at local levels that will serve as the implementing agencies in applying new technology, identifying redundant efforts, defining the requirements of the disabled to industry participants and searching out needs as yet unspecified.

The plan envisages the use of research facilities and technically qualified personnel as well as financial support from participating corporations. In keeping with the President's message, this project is to be financed and operated by the private sector.

CONCEPTS FOR INDEPENDENT LIVING
P.O. BOX 2001
WASHINGTON, D.C. 20013
202/857-0087

The magnitude and importance of this program merits the support of the entire nation. We urgently solicit the participation of your corporation at a level that befits an undertaking of this nature and scope. Financial contributions in the range of $25,000, $50,000, $75,000 or more plus contributions of "in-kind" support are needed to ensure the success of the program.

Concepts for Independent Living has arranged with the Riggs National Bank of Washington, D.C. to act as the repository for contributions. The wholehearted support of your corporation will be of great help in making independent living for the disabled as much of a reality as . . . a man on the moon.

Sincerely,

J.B.L. Pierce
Vice Chairman

Enclosures: - suggested format for the response
- Concepts brochure

CONCEPTS FOR INDEPENDENT LIVING
P.O. BOX 2001
WASHINGTON, D.C. 20013
202/857-0087

MEMORANDUM

Date:

To: Secretary Margaret Heckler, Department of Health and Human Services
Secretary Casper Weinberger, Department of Defense
Administrator James Beggs, National Aeronautics and Space Administration

From:

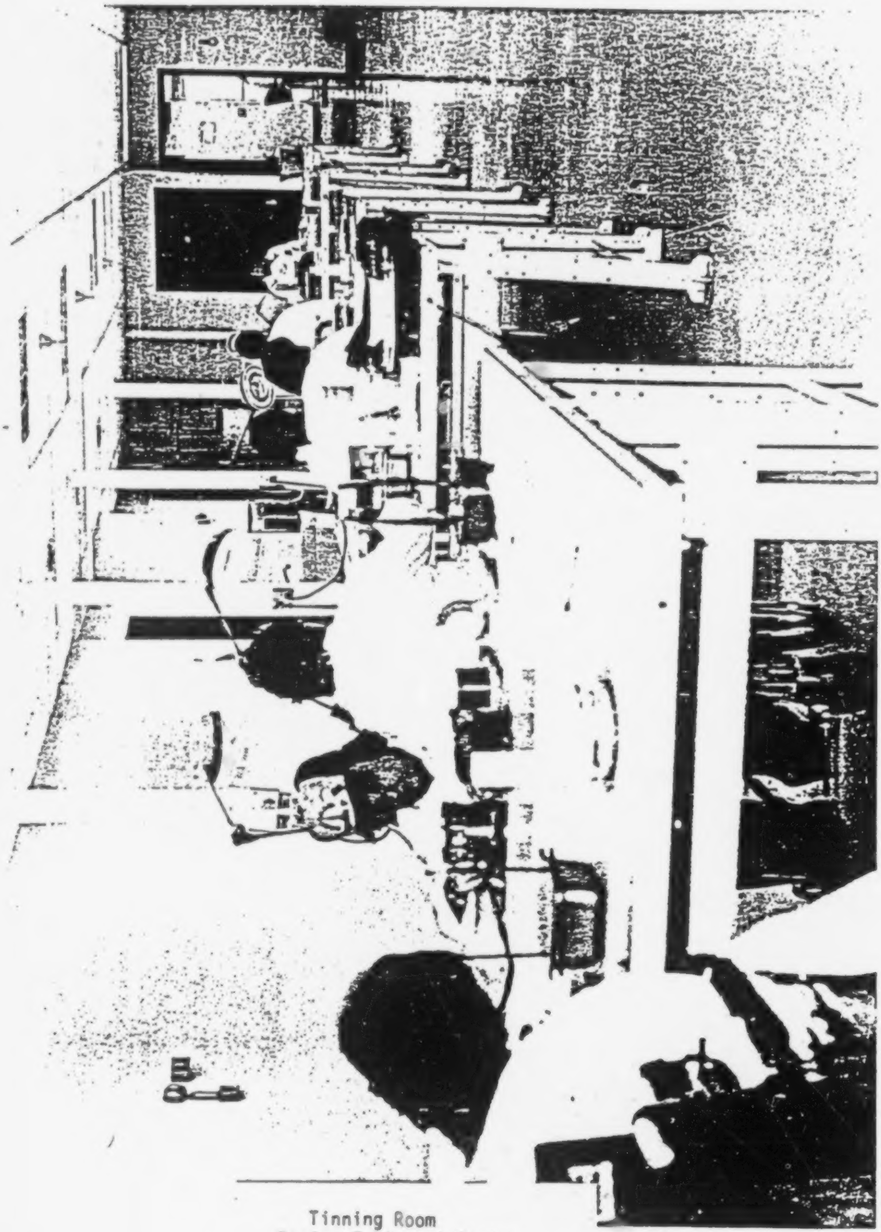
My company would be honored to join you in an initiative on technology and the disabled. We would be very interested in pursuing a public/private sector effort building upon existing and new applications of technology to address the needs of the disabled.

Please count on this company to assist in your efforts. We understand that new methods of answering the particular needs of the disabled must be developed. Also, we understand that our company is a necessary component in this process. You may be assured we will do our part to enhance the freedom and dignity of the disabled.

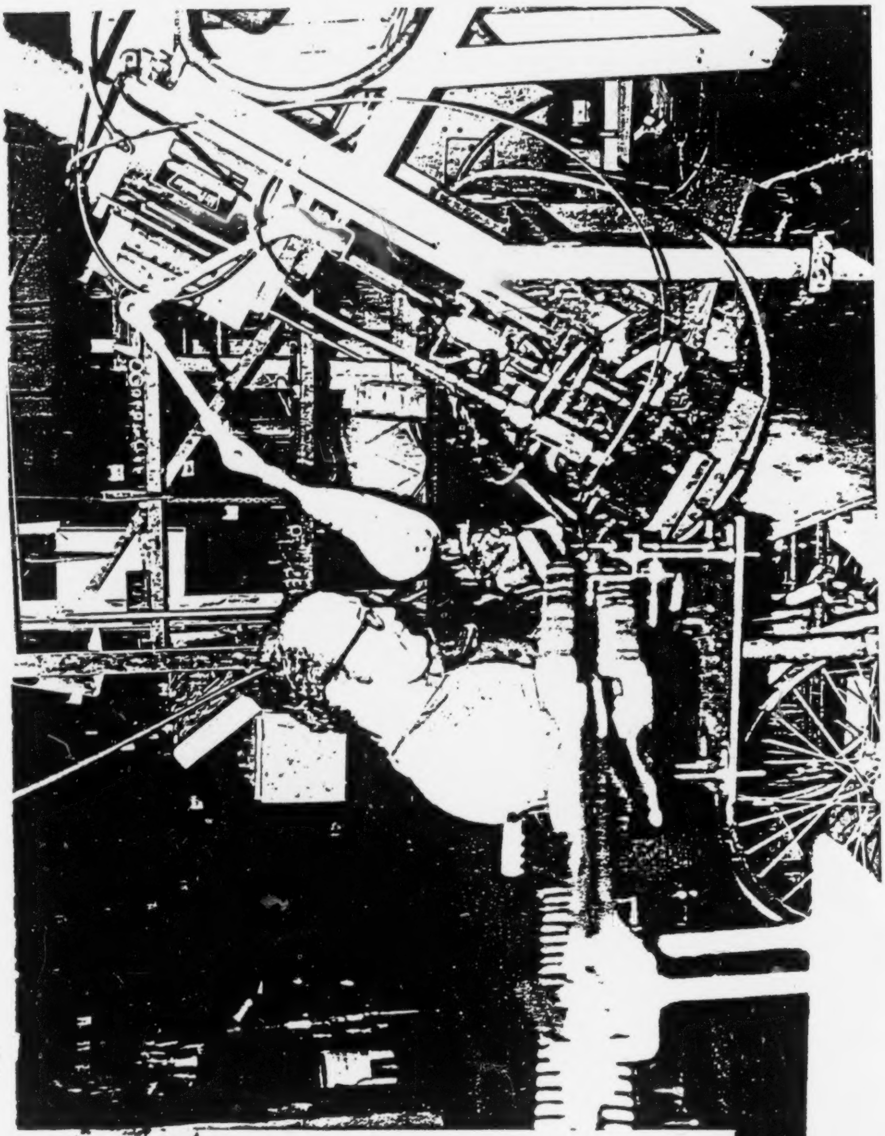
Sincerely,

Chief Executive Officer

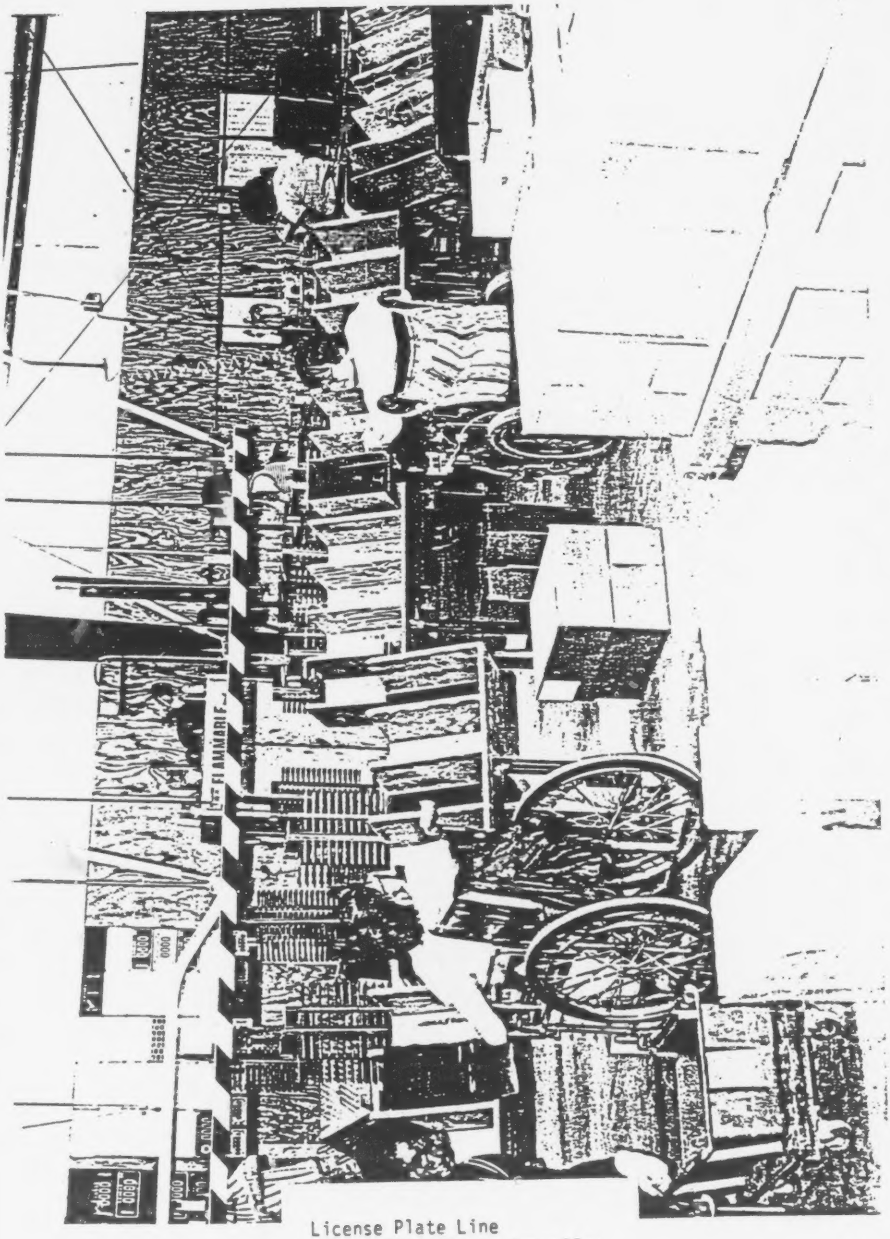
Note: Your responses may be mailed to the Honorable Secretary Margaret M. Heckler, Secretary of Health and Human Services, Washington, DC 20201. Her office will deliver copies to Secretary Weinberger and Administrator Beggs.



Tinning Room
Boeing Equipment Parts



Farm Tool Engineering
Production Modification



License Plate Line
One-Million Plates Annually

The **Chairman**. Thank you both very much.

It is not my intention now to ask questions. I will come back to that. However, I do want to reemphasize two points that have been made by the first two witnesses because they refute the information that has been given to the American public from the administration, more particularly Mr. Stockman.

No. 1, in both these instances, both in the instances of Cray and in the instances of the Center Industries Corp., total financing required was not available through the private sector. I repeat, total financing was not available through the private sector. An important piece of that financing came from the Federal Government.

Point No. 2. Again the testimony of both witnesses, one a very successful American corporation, the other a successful business dealing with that segment of our population that needs some special care—shows that much more has been given back to the U.S. Government than was borrowed from the U.S. Government.

I might add that the taxes that have been cited in instances of both these entities do not necessarily include all the taxes that are being paid by the individuals that are employed. If you add that to it, it becomes almost staggering.

Let's understand that we are not talking about any charity here, or handouts, or defaults, or anything that is costing the taxpayer money. Indeed, if these activities had not taken place, there would have been an outflow of funds. There would have been a lot of people not employed. The opportunities would not have been there.

The next witness is Mr. Edward Lewis, publisher and chief executive of Essence Communications, Inc., of New York City, NY.

Mr. Lewis, nice to have you here.

STATEMENT OF EDWARD LEWIS, PUBLISHER AND CHIEF EXECUTIVE, ESSENCE MAGAZINE, NEW YORK CITY, NY

Mr. **Lewis**. Thank you.

Good morning, Mr. Chairman and members of the committee.

My name is Edward Lewis, and I am the publisher and chief executive officer of Essence Communications, Inc.

Essence magazine, the leading magazine for black women, now has a circulation of 800,000 and advertising revenues of $11 million. In addition, Essence Communications now produces a weekly television program on NBC in New York as well as in 49 other markets. We also have an Essence by mail catalog and a licensing division for intimate apparel. The company employs 90 people, and we have revenues of $20 million.

Essence was the first publication to examine the black woman's contribution to her race, society, and country. We have expanded from print into broadcast media so that black women—as well as black men and other individuals in our society—can see and hear as well as read about the values, hopes, dreams, accomplishments, and lifestyles of black women.

Essence, as the numbers show, is a success story—so much so that you may wonder why a company with $20 million in the revenue column is testifying today about the need for the Small Business Administration. To explain, I would like to turn back the pages of Essence about 15 years.

Clarence Smith and I founded Essence back in 1970 with startup financing from MESBIC's and other sources. Like many new ventures, we started with sound and exciting ideas, got the product off to a good start, but soon began to feel our financial foundations wobbling. In 1973 our 3-year-old brainchild had 25 employees, sales of $1.5 million, and losses so heavy that I still shudder to remember.

Part of our startup financing had come from the MESBIC industry, and while most investors in a situation like ours would move quickly to cut their losses, our venture capital investors stayed for the long haul. In fact, these MESBIC executives worked the numbers carefully—from operating costs to market potential—and determined that Essence had the growth and profitability potential to warrant a larger financial commitment than before.

Five MESBIC's syndicated an investment in Essence of over $1 million. These MESBIC's include: Minority Equity Capital Co., Inc. [MECCO] in New York; Equico Capital Corp. of New York, a subsidiary of the Equitable Life Assurance Co. of the United States; BANCAP Corp. of New York; North Street Capital Corp. of White Plains, NY, a subsidiary of General Foods Corp.; Pioneer Capital, and Motor Enterprises, Inc., a subsidiary of General Motors Corp.

Clarence Smith and I turned the company around, and today—you heard the figures earlier. Our projections for next year are $25 million in revenues, and profits will be substantial. In addition to the fine publication we have created, the market we serve, the excellent women and men we employ, the taxes we pay and the profits we enjoy, Essence has repaid $800,000 to our MESBIC investors who have paid back their loans to the Small Business Administration.

The success of Essence rests on a number of factors. There was a powerful need—a ready market—for the product. In terms of management, Clarence Smith and I had a lot to learn at the outset, but we were blessed with ability and perseverance so hard to pinpoint in entrepreneurs, and willing advisors—important ingredients for the company's turnaround and continuing success.

But just as important as the product, market and management, our MESBIC investors were committed to Essence's success and tenacious about getting there. They believed the product was important to the black market, and they saw a winner. The MESBIC's were there to stay.

Essence is a success. It's kind of like football—it feels good to identify with a winner. But you may also be thinking, "Essence is a glamour investment. What does it have to do with the other MESBIC investments and SBA as a whole?" Before inviting your questions, I would like to address that topic.

Essence is a solid investment. It is fun to own a publishing company that produces a quality product that becomes an advertiser's delight. But for every high profile company that venture capitalists in the MESBIC industry capitalize, they invest in hundreds of other minority businesses. The blacks, Hispanics, Asians, and American Indians who own and operate these businesses produce ball point pens and food products; they do tool and die work and distribute paper products; they run fast food franchises and develop computer software; they design and manufacture furniture; provide accounting services; process film; mix chemicals and package fertilizers. In 1984 alone, MESBIC's financed 1,087 minority businesses, double the number financed in 1980.

Not all of these companies come out on top. After all, the risks to entrepreneurs and venture capitalists are well known. But many of these companies do well, and their success is measured in a number of ways.

Jobs are not the first measure for Wall Street, but I think they are important, and in 1984 companies financed by MESBIC's employed over 8,400 people. What's more, the majority of these jobs are located in inner cities, rural areas, and communities struggling to build up their economies. Many of the men and women employed in these jobs would otherwise be forced onto unemployment compensation rolls or other forms of Government assistance. Do we really want that?

Many of these companies also do well in terms that fill the pages of my publishing associates in the financial field. The industry association for MESBIC investors is currently polling members about the number of companies that have increased total revenues, increased sales, achieved profitability, opened up new markets, introduced new products or services, acquired all or part of another company, increased their number of employees, or turned around. The results will not be in until March, but as professionals in your own fields, you may know that surveys are not conducted by pessimists.

I am a publisher, not a lawyer, and while my facts do make a case, I have really just told you a story, the story of Essence Communications, of which the MESBIC industry and the other minority businesses its venture investors have capitalized, are an important part.

I know that you have a formidable task in weighing the costs and benefits of SBA and its components.

At this point I will welcome the opportunity to provide additional information to assist you in your task. I, for one, do not view the SBA as a subsidized service organization. Through financing vehicles such as the SBIC industry and other programs, I think that careful numbers crunchers will discover that SBA is a net asset to our economy when jobs, tax revenues, and other measures are hanging in the balance.

Thank you very much.

[The prepared statement of Mr. Lewis follows:]

ESSENCE.

EDWARD LEWIS
Publisher
Chief Executive

TESTIMONY

BY

EDWARD LEWIS, PUBLISHER
CHIEF EXECUTIVE

OF

ESSENCE MAGAZINE

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

THURSDAY, FEBRUARY 21, 1985

1500 Broadway, New York, New York 10036 (212) 730-4260

Good Morning Mr. Chairman and members of the committee. My name is Edward Lewis and I am publisher and chief executive officer of Essence Communications, Inc.

Essence Magazine, the leading magazine for black women, now has a circulation of 800,000 and advertising revenues of $11,000,000. In addition, Essence Communications now produces a weekly television program on NBC in New York as well as in 49 other markets. We also have an Essence by Mail catalogue and a licensing division for intimate apparel. The company employs 90 people, and has revenues of $20,000,000.

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CLARENCE SMITH AND I FOUNDED ESSENCE BACK IN 1970 WITH START-UP FINANCING FROM MESBICS AND OTHER SOURCES. LIKE MANY NEW VENTURES, WE STARTED WITH SOUND AND EXCITING IDEAS - GOT THE PRODUCT OFF TO A GOOD START -- BUT SOON BEGAN TO FEEL OUR FINANCIAL FOUNDATIONS WOBBLING. IN 1973 OUR THREE-YEAR-OLD BRAINCHILD HAD 25 EMPLOYEES, SALES OF $1,500,000 AND LOSSES SO HEAVY THAT I STILL SHUDDER TO REMEMBER.

PART OF OUR START-UP FINANCING HAD COME FROM THE MESBIC INDUSTRY, AND WHILE MOST INVESTORS IN A SITUATION LIKE OURS WOULD MOVE QUICKLY TO CUT THEIR LOSSES, OUR VENTURE CAPITAL INVESTORS STAYED FOR THE LONG HAUL. IN FACT, THESE MESBIC EXECUTIVES WORKED THE NUMBERS CAREFULLY - FROM OPERATING COSTS TO MARKET POTENTIAL - AND DETERMINED THAT ESSENCE HAD THE GROWTH AND PROFITABILITY POTENTIAL TO WARRANT A LARGER FINANCIAL COMMITMENT THAN BEFORE.

FIVE MESBICS SYNDICATED AN INVESTMENT IN ESSENCE OF OVER $1 MILLION. THESE MESBICS INCLUDE: MINORITY EQUITY CAPITAL COMPANY, INC. (MECCO) OF NEW YORK; EQUICO CAPITAL CORPORATION OF NEW YORK, A SUBSIDIARY OF THE EQUITABLE LIFE ASSURANCE COMPANY OF THE U.S.; BANCAP CORPORATION OF NEW YORK; NORTH STREET CAPITAL CORPORATION OF WHITE PLAINS, NEW YORK, A SUBSIDIARY OF GENERAL FOODS CORPORATION; PIONEER CAPITAL, AND MOTOR ENTERPRISES, INC., A SUBSIDIARY OF GENERAL MOTORS CORPORATION.

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But just as important as the product, market and management, our MESBIC investors were committed to Essence's success and tenacious about getting there. They believed the product was important to the black market, and they saw a winner. The MESBICs were there to stay.

Essence _is_ a success. It's kind of like football -- it feels good to identify with a winner. But you may also be thinking, "Essence is a glamour investment. What does it have to do with the other MESBIC investments and SBA as a whole?"

BEFORE TALKING ABOUT THE TRACK RECORDS OF THESE PROGRAMS, I WOULD LIKE TO ADDRESS THE TERMS OF THE DEBATE OVER THE VALUE OF THESE PROGRAMS. BUDGET CUTTERS MOST OFTEN COUCH THE DEBATE IN TERMS OF VALUE RECEIVED FOR USE OF THE TAXPAYERS DOLLARS. THE DEFICIT MUST GO DOWN AND I THINK THAT THIS MEASURE OF VALUE IS A VALID ONE. UNFORTUNATELY, HOWEVER, ADVERSARIAL RATHER THAN PROBLEM SOLVING APPROACHES TO OUR SHARED PROBLEM LEAD TO EXTRAORDINARILY NARROW DEFINITIONS OF VALUE.

JUDGMENTS OF HOW WELL SBA SPENDS TAX DOLLARS SHOULD BE MEASURED IN TERMS OF JOBS CREATED, AND THE CONSEQUENT REDUCTION OF DEPENDENCE ON GOVERNMENT ASSISTANCE. VALUE SHOULD ALSO BE MEASURED IN TERMS OF BUSINESSES CREATED THAT BECOME PART OF COMMUNITY ECONOMIC INFRASTRUCTURES, AND THE AMOUNT OF PAYROLL AND INCOME TAXES THESE BUSINESSES PAY TO LOCAL, STATE AND FEDERAL GOVERNMENTS.

SINCE THE MESBIC PROGRAM IS THE SBA PROGRAM THAT I KNOW BEST, LET ME RETURN TO THE MESBIC INDUSTRY FOR PURPOSES OF ILLUSTRATING THE TRACK RECORD OF AN IMPORTANT SBA PROGRAM.

SBA HAS A VARIETY OF SUCCESSFUL FINANCIAL VEHICLES THAT ADDRESS A CROSS-SECTION OF SMALL BUSINESS NEEDS. ALONG WITH THE SBIC AND MESBIC PROGRAMS, THEY INCLUDE:

- DIRECT LENDING FOR SMALL COMPANIES THAT NEED FINANCING THAT IS DIFFICULT TO OBTAIN THROUGH NORMAL COMMERCIAL CHANNELS;
- GUARANTEED LENDING DESIGNED TO HELP SMALL BUSINESSES OBTAIN CAPITAL AND AT THE SAME TIME SPUR ECONOMIC GROWTH;
- SECTION 503 DEVELOPMENT COMPANIES, INSTITUTIONS THAT PROVIDE "BRICKS AND MORTAR" FINANCING FOR SMALL BUSINESSES THAT NEED TO ACQUIRE LAND, CONSTRUCT, EXPAND OR RENOVATE BUILDINGS, AND ACQUIRE EQUIPMENT;
- SMALL BUSINESS INVESTMENT COMPANIES, A PRIVATE SECTOR-GOVERMENT PARTNERSHIP CREATED 25 YEARS AGO TO PROVIDE RISK CAPITAL FOR SMALL BUSINESS WHERE NONE EXISTED; AND
- MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANIES, CREATED OVER 15 YEARS AGO TO ADDRESS ANOTHER FINANCING NEED -THE INVESTMENT OF RISK CAPITAL IN MINORITY BUSINESSES.

FOR EVERY HIGH PROFILE COMPANY LIKE ESSENCE THAT VENTURE CAPITALISTS IN THE MESBIC INDUSTRY FINANCES, THEY INVEST IN HUNDREDS OF OTHER MINORITY BUSINESSES. THE BLACKS, HISPANICS, ASIANS, AND AMERICAN INDIANS WHO OWN AND OPERATE THESE BUSINESSES PRODUCE BALL POINT PENS AND

FOOD PRODUCTS, THEY DO TOOL AND DIE WORK AND DISTRIBUTE PAPER PRODUCTS, THEY RUN FAST FOOD FRANCHISES AND DEVELOP COMPUTER SOFTWARE, THEY DESIGN AND MANUFACTURE FURNITURE, PROVIDE ACCOUNTING SERVICES, PROCESS FILM, MIX CHEMICALS AND PACKAGE FERTILIZERS. IN 1984 ALONE, MESBICS FINANCED 1087 MINORITY BUSINESSES, DOUBLE THE NUMBER FINANCED IN 1980.

NOT ALL OF THESE COMPANIES COME OUT ON TOP. AFTER ALL, THE RISKS TO ENTREPRENEURS AND VENTURE CAPITALISTS ARE WELL KNOWN. BUT MANY OF THESE COMPANIES DO WELL, AND THEIR SUCCESS IS MEASURED IN A NUMBER OF WAYS.

JOBS ARE NOT THE FIRST MEASURE FOR WALL STREET, BUT I THINK THEY ARE IMPORTANT, AND IN 1984 COMPANIES FINANCED BY MESBICS EMPLOYED OVER 8,400 PEOPLE. WHAT'S MORE, THE MAJORITY OF THESE JOBS ARE LOCATED IN INNER CITIES, RURAL AREAS AND COMMUNITIES STRUGGLING TO BUILD UP THEIR ECONOMIES. MANY OF THE MEN AND WOMEN EMPLOYED IN THESE JOBS WOULD OTHERWISE BE FORCED ONTO UNEMPLOYMENT COMPENSATION ROLLS OR OTHER FORMS OF GOVERNMENT ASSISTANCE.

MANY OF THESE COMPANIES ALSO DO WELL IN TERMS THAT FILL THE PAGES OF MY PUBLISHING ASSOCIATES IN THE FINANCIAL FIELD. THE AMERICAN ASSOCIATION OF MESBICS IS CURRENTLY POLLING MEMBERS ABOUT THE NUMBER OF COMPANIES THAT HAVE INCREASED TOTAL REVENUES, INCREASED SALES, ACHIEVED PROFITABILITY, OPENED UP NEW MARKETS, INTRODUCED NEW PRODUCTS OR SERVICES, ACQUIRED ALL OR PART OF ANOTHER COMPANY, INCREASED THEIR NUMBER OF EMPLOYEES, OR TURNED AROUND. THE RESULTS WILL NOT BE IN UNTIL MARCH, BUT AS PROFESSIONALS IN YOUR OWN FIELDS, YOU KNOW THAT SURVEYS ARE NOT CONDUCTED BY PESSIMISTS.

FROM SBA'S POINT OF VIEW, THE LOSS RATION ON FUNDS INVESTED THROUGH THE MESBIC PROGRAM OVER A 15 YEAR PERIOD IS LESS THAN 1%. PLEASE REMEMBER, THIS LOSS RATIO IS IN THE VENTURE CAPITAL AREA WHERE RISKS ARE HIGH AND PROFITS A LONG TIME IN COMING. FROM MY POINT OF VIEW, THE RATIO SPEAKS WELL FOR THE VENTURE CAPITALISTS -- AND ENTREPRENEURS AND MANAGERS -- WHO HAVE INVESTED THEIR PERSONAL CAPITAL IN PICKING WINNERS AND RUNNING COMPANIES OVER THE HISTORY OF THE PROGRAM.

I'M A PUBLISHER, NOT A LAWYER, AND WHILE MY FACTS DO MAKE A CASE I HAVE REALLY JUST TOLD YOU A STORY - THE STORY OF ESSENCE COMMUNICATIONS, OF WHICH THE MESBIC INDUSTRY AND THE OTHER MINORITY BUSINESSES ITS VENTURE INVESTORS HAVE CAPITALIZED ARE AN IMPORTANT PART.

I KNOW THAT YOU HAVE A FORMIDABLE TASK IN WEIGHING THE COSTS AND BENEFITS OF SBA AND ITS COMPONENTS. I, FOR ONE, DO NOT VIEW THE SBA AS A SUBSIDIZED SERVICE INDUSTRY.

THROUGH FINANCING VEHICLES SUCH AS THE SBIC INDUSTRY AND OTHER PROGRAMS, I THINK THAT CAREFUL NUMBERS CRUNCHERS WOULD DISCOVER THAT SBA IS A NET ASSET TO OUR ECONOMY WHEN JOBS, TAX REVENUES AND OTHER MEASURES ARE HANGING IN THE BALANCE.

THANK YOU, MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, FOR THE OPPORTUNITY TO TELL YOU ABOUT MY CONVICTIONS ABOUT SBA. AT THIS POINT I WOULD WELCOME THE OPPORTUNITY TO PROVIDE ADDITIONAL INFORMATION TO ASSIST YOU IN YOUR TASK.

The CHAIRMAN. Thank you very much, Mr. Lewis. We will return for questioning after we hear from our final witness on this panel, Mr. Arthur Chase, president of the Arthur Chase Management Corp. of Westborough, MA.

Mr. Chase.

STATEMENT OF ARTHUR E. CHASE, PRESIDENT, ARTHUR E. CHASE MANAGEMENT CORP., WESTBOROUGH, MA

Mr. CHASE. Mr. Chairman, my name is Arthur Chase. I was a cofounder of the Chase Paper Co. and up until several months ago a coowner. In July of this past year I sold my interest in the Chase Paper Co.

I am privileged to be here this morning. The comments that I am making are based on my personal experience in building a company that started with $100 in net assets into one of the most prestigious automated specialty printing companies in the United States.

The company was started in 1947 with my brother and my father. We started by selling blank wedding invitation paper to printers. After a few years of doing this, we thought that perhaps if we set up a business where we specialized in a very narrow area of the printing industry, printing invitations only, we would be able to automate the typesetting process; we would be able to automate the press process itself; we would be able to purchase the blank announcement stock in larger and more economical quantities, and, in effect, be able to produce the product for printers at a cheaper price than they could print the order themselves.

The end result was that we have produced a product that is far superior in quality, much better designed, much less expensive for brides or any consumer of invitations. As a matter of fact, in 1980 our company was selected to print all the commemorative and special event invitations for the inauguration of President Reagan.

I am here this morning to tell you how we took this company and built it into a $12-million-a-year operation. I want to state emphatically that, without the help of the SBA, this would not have been possible.

Our business was not a glamourous business. My father, my brother, and I had no assets to pledge to banks for loans in order to be able to purchase the equipment that was necessary. Our customers were made up of small printers, usually one-, two-, three-, or four-person operations. Therefore, our customers had no credit rating, so we had no real accounts receivable that we could pledge to the bank. Our inventory did not have much benefit to the banks. They were not interested in taking back, if they had to, blank invitation paper. The equipment that we wanted to purchase was very highly specialized and, therefore, had little value on the resale market.

We had always met our obligations; we met them on time. But, at the same time, we were still classified as a nonbankable company.

For 20 years we seemed to run on an endless treadmill. We grew very little each year. We put the profits back into the company. But the turning point came in 1966 when our bank introduced us to the SBA. From 1966 to 1974, a period of 8 years, we secured six loans from our bank made in conjunction with the SBA. The SBA was a participant in some; guaranteeing others. Those loans would not have been available to us had it not been for that participation or the guarantees by the SBA.

The money was used to purchase sophisticated equipment, research and development, advertising, and bricks and mortar to build an adequate modern facility.

Of major importance were the sessions that we had with the loan officer from the SBA and the loan officer from our bank as well, where they stressed financial controls, long-range planning, cash projections, the need for modern, sophisticated equipment.

During that 8-year period our sales grew from $500,000 a year to $2.5 million a year. That is an increase of 500 percent in an 8-year period.

The company is now doing $12 million a year in sales. It is now a profitable company. It is a viable company. It is a tax-paying company as well.

As a matter of fact, this past year alone in corporate income taxes the company paid more than the total of the $420,000 that it had borrowed over that 8-year period. If you add to the amount that the company paid in corporate taxes the amount that was withheld from our employees for income tax, the Government received in this past year alone over double the $420,000 that they had loaned to us.

I think that we should all bear in mind, also, that the loans that we received were not gifts or grants; they were obligations that had to be paid, and paid with interest.

In addition, during that period we have increased employment to approximately 400 people. We have established a profit-sharing program. Over this past year alone a quarter of a million dollars was distributed to our employees. Four years ago we started a scholarship program for our employees' children. During that 4-year period we have contributed over $80,000 in scholarships.

Since the last loan that the company received from the Government in 1974, the company has become very bankable, has not had to rely or go back to the SBA for additional loans or guarantees.

I am not concerned with the future of the SBA for my own benefit, because I have sold my interest in the company 6 months ago, but I am concerned that other people have the same opportunity that we had.

Over the years we have added to the printing industries of America. We have shared our knowledge with them. We have added to the growth of the printing industry, and we have certainly added to the employment resources of our community.

The Government extended to us a strap of support. We were able to grab hold of that strap and lift ourselves up and be able to participate in the American dream—to be in business for ourselves, to create jobs for hundreds of people, and to share in the economic wealth of the country. For that, I am grateful, and I just hope that that opportunity is extended to others in the future. Thank you.

[The prepared statement of Mr. Chase follows:]

Statement by:
ARTHUR E. CHASE, President, Arthur E. Chase Management Corp.
30 Oak Street, Westborough, MA 01581
(Former Co-owner and Treasurer,
Chase Paper Company, Inc. 1947-1984)
SENATE SMALL BUSINESS COMMITTEE
February 21, 1985

I feel privileged to testify this morning on behalf of the Small Business Administration. My comments are based on my personal experience in building a company from a net worth of $100.00 to one of the largest most prestigious automated specialty printing plants in America. A company that is not high-tech, but utilizes the most sophisticated computer controls and management techniques in order to produce custom crafted invitations at prices affordable in the mass market place. Our first year sales were $25,000. With the absence of adequate financing, it took almost 20 years (1947-1966), for the company of three to grow into a company employing 40 people with annual sales of approximately $500,000 per year.

My father, my brother and I started Chase Paper Company in 1947 in the back room of a laundry. Our business then was selling blank invitation paper to printers. We sold during the day and did the billing, shipping, and other record keeping at night.

After 4 or 5 years of selling specialized announcement paper and growing at a very slow rate, we developed the idea that by specializing in a very narrow area of the printing business - only printing invitations - we could automate the setting of type, we could automate the custom printing that is required on each order of 100 invitations and we could purchase the specialty paper in larger more economical quantities. We could produce an invitation order for the printer at a price that would give us a profit and provide a finished product to the printer at a price far less than he could produce the order for himself. Simply put, the idea was to mass produce a highly customized, personalized order of invitations.

We grew through the various critical business stages, and succeeded to the point where our company was selected in 1980 to print all the official commemorative and special event invitations for the inauguration of President Reagan. Not only by mass producing a custom product have we lowered the price to the ultimate consumer, but we have created a product far superior in quality and design than was possible in the past.

Chase Paper Company facilities presently are amongst the most modern in the country. Every order is computer controlled from the minute it enters the plant through the final shipping stage. The average order has a value of approximately $50.00, and the company processes over 4000 individual orders each week. The company employs approximately 400 people, has sales of over 12 million per year. It is successful and profitable.

The reason I'm here this morning is to tell you how we got to that point, and to state emphatically that if it were not for the help of the SBA - both financially and managerially - Chase Paper Company would have died along the way.

We were not in a glamourous business. My father, brother, and I had no assets that could be pledged on loans. Our customers were small printers in most cases without any credit rating so that banks would not loan us on our accounts receivable. Our inventory was specialized - blank wedding stationery, and odd size matching envelopes. This was not a good inventory item for banks to take for security. The equipment that we needed was highly specialized and therefore had very little resale value. Although we had always met our obligations on time, we were considered "non-bankable".

For the first 20 years, it seemed that we ran an endless treadmill. Our small but steady profits were continuously plowed back. Never did we have sufficient assets for a bank to loan us the money necessary for a proper planned expansion.

The turning point came in 1966 when we were introduced to the SBA by our bank. In a period of 8 years, from 1966 to 1974, we secured six SBA loans made in conjunction with our bank in order to cover a variety of business needs including machinery, bricks and mortar, working capital, and relief from a natural disaster. These loans would not have been possible if the SBA had not been a participant with the bank or a guarantor. The total SBA portion of the six loans amounted to approximately $420,000. The loans allowed us to buy sophisticated specialized equipment, allowed money for advertising and for research and development. The loans provided the guarantees for bank financing in order to build a modern facility. Of major importance were the sessions with our SBA loan officer who continuously stressed adequate financial controls, long range planning, cash projections, and modern equipment. During that eight year period of SBA loans, our sales grew from $500,000 to almost 2 1/2 million a year, an increase of 500% in 8 years.

The sales of Chase Paper Company have continued to grow and are now over 12 million per year and most important to ourselves and to the government, Chase is a profitable, viable, tax paying company. This past year alone, federal and state taxes paid by Chase exceeded the total dollar amount of all its SBA loans. Bear in mind also that these loans were not gifts or grants, they were obligations that have been paid, and paid with interest. In addition, the company provides employment for 400 people and has a profit sharing plan that distributed approximately $250,000 this past year alone. Four years ago, we started a scholarship fund for our employees' children to which the company to date has contributed over $80,000.

Since the last SBA loan in 1974, Chase has become very "bankable" and no longer needs injections of capital or loan guarantees from the SBA.

I believe that the strength of our nation's economy lies not only in large companies. The small companies of 5-500 employees that dot the countryside provide stability for communities. It is their diversity that levels out the economic peaks and valleys resulting from having only a few large corporations. Small companies have continuously led the country in technological breakthroughs. The value of the entrepreneurial spirit of small companies is now recognized by major corporations. Latest management techniques call for the unitizing of their corporations into entrepreneurial divisions.

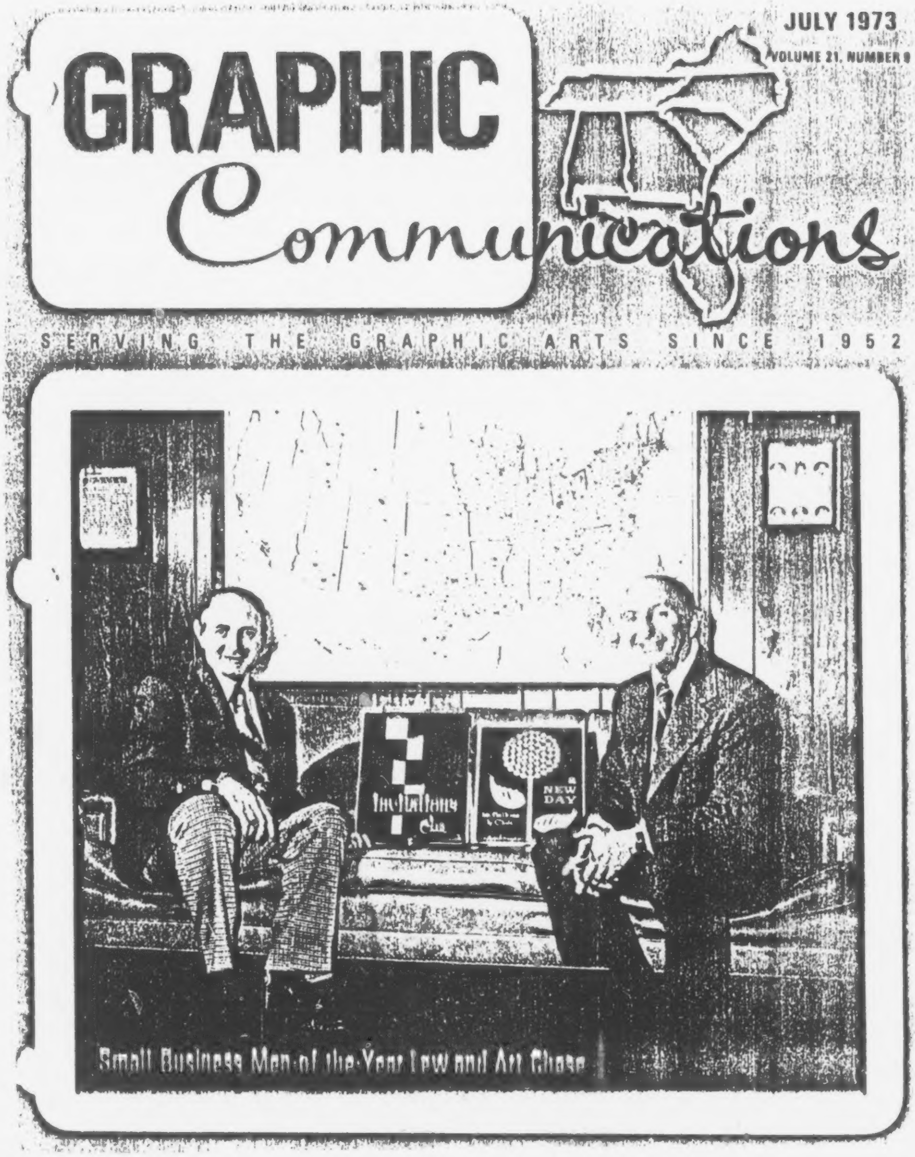
The opportunity that we had should be available to all people. Like many successful businesses, we went through a series of growing stages. Each stage required changes in management style and usually additional capital to support increased sales which meant greater inventory, higher accounts receivable, more equipment, and larger quarters.

The SBA was there during those critical business cycles. The SBA was also there when a natural disaster struck the town of Westboro. A hurricane coupled with flooding wiped out a substantial portion of our inventory and samples. Without a disaster loan we would have been a casualty then and there.

I am not concerned with future SBA help for myself. This past year I sold my interest in Chase Paper Company. I am concerned that others should have the opportunity that I had.

We have shared our techniques with people within our industry. We have added to the growth of the Printing Industries of America and most certainly have added to the employment resources of our community.

I am thankful for having had the opportunity to be part of the American dream -- to be in business for myself, to provide employment for hundreds of others, and to share in the economic wealth of our country.



GRAPHIC Communications

JULY 1973

VOLUME 21, NUMBER 9

SERVING THE GRAPHIC ARTS SINCE 1952

Small Business Men of the Year Lew and Art Chase

GRAPHIC
COVER STORY

Men of the Year:

Lou and Art Chase Built Nation-Wide Business With Help of S B A

The printing industry is honored as the Small Business Administration gave recognition to Lewis and Arthur Chase of Chase Paper Company Inc. as 1973's Small Businessmen of the Year.

The May 8 announcement stated that "their growth and success can be attributed to a team of brothers with a common goal and a drive and determination to succeed, and a government that provides opportunity for people without prior wealth to go into business, and the Small Business Administration willing to provide seed money and counseling."

Chase, as readers of Grap[illegible] Communications' advertisi[illegible] columns are aware, produces thermographed social stationery and other specialty items as a trade source with unique delivery procedures that allows it to compete in all markets throughout the country.

The business started in 1948 when Israel A. Chase and his two sons, then 18 and 20, started in a 12x15 back room with $100 capital and $100 in credit. Selling blank invitation paper to printers their first year sales were $25,000.

A corner of the computer input dep[illegible] ment shows Flexowriters and oth[illegible] perforators used for order-booking and typesetting.

In 1973 the company occupies a 50,000 square foot plant on five acres in the Chase family's Westboro Industrial Park.

The decision to become a trade source for the complete invitation found bankers unwilling to finance such things as 1000 catalogs at $10 each. By 1966, however, SBA financing through a Worcester bank provided capital for large scale distribution of catalogs and electronic equipment necessary.

Within seven years sales had increased five times, partly due to four major industry innovations:

1. Overnight delivery by air-[illegible]go coast to coast. This puts an [illegible]ler received on Monday morning back in Miami on Thursday.

2. Introduction of bright colored stock into the wedding field.

3. Computer controlled production including order processing, typesetting, shipping control and invoicing.

4. Installation of national IN-WATS service so that any printer in the country is only a phone call away from expert advice.

Both of the Chases have participated in the Graphic Arts Congress held biennially in Orlando. Lou's educational background included Worcester Junior College and the New England Conservatory of Music. (He once played saxophone and clarinet in dance bands and formed the Lou Chase orchestras.) He is a past vice president of Optimist International at Tampa, and a former vice president of B'nai B'rith in Tampa. He was an assistant instructor for Dale Carnegie Courses in Tampa and past president of the Dale Carnegie Alumni Association there.

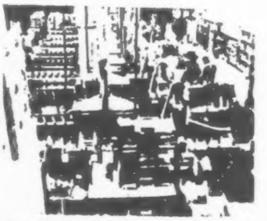
Arthur Chase has a similar record [illegible]civic activity in the Worchester, [illegible]ass., vicinity, including such organizations as the County Light Opera Club, the local chapter for the advancement of management, good government and planning groups, and the International Thermographers Association of which he is currently president.

These steel racks enable expeditors to control thousands of orders and assure a high degree of 48-hour service.

Purchased with the first SBA loan was a computer controlled Photon. Using perforators with standard keyboards the computer produces order instructions, invoice, shipping instructions, and the variable copy for the typesetting of a wedding invitation.

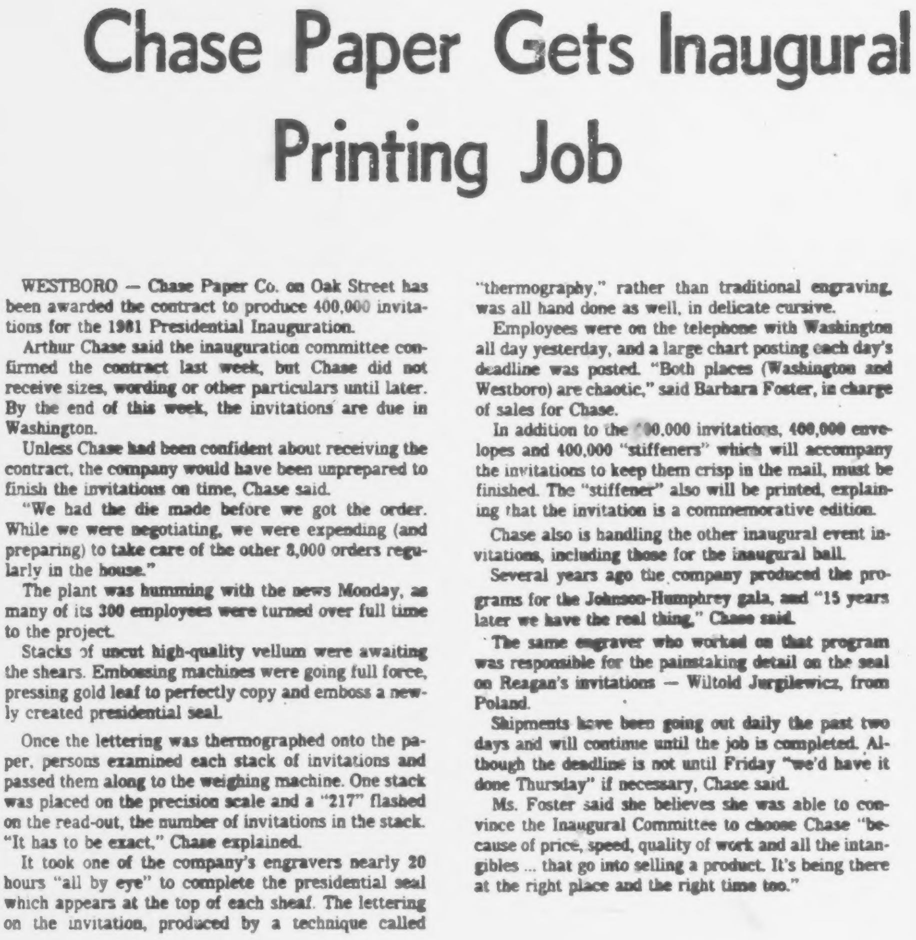
As many as ten patients at nearby Westboro state hospital have been involved in training programs at Chase. Several have been rehabilitated and some are now working a full time basis either at Chase or other companies in their home towns.

In 1966 the U.S. Department of Labor certified Chase's first On-Job training program; several of the original six are now key employees. Chase has participated in the National Alliance of Businessmen program and has been under contract with Labor to train four hard-core Spanish speaking unemployed individuals.



Raised letter printing is a continuousl[illegible] automated operation which starts [illegible] offset presses on the right. Foil stamp[illegible] equipment at Chase produced Inauguration Gala covers for the Johnson-Humphrey administration.

/From theWorcester Telegram, Dec. 10, 1980/



Chase Paper Gets Inaugural Printing Job

WESTBORO — Chase Paper Co. on Oak Street has been awarded the contract to produce 400,000 invitations for the 1981 Presidential Inauguration.

Arthur Chase said the inauguration committee confirmed the contract last week, but Chase did not receive sizes, wording or other particulars until later. By the end of this week, the invitations are due in Washington.

Unless Chase had been confident about receiving the contract, the company would have been unprepared to finish the invitations on time, Chase said.

"We had the die made before we got the order. While we were negotiating, we were expending (and preparing) to take care of the other 8,000 orders regularly in the house."

The plant was humming with the news Monday, as many of its 300 employees were turned over full time to the project.

Stacks of uncut high-quality vellum were awaiting the shears. Embossing machines were going full force, pressing gold leaf to perfectly copy and emboss a newly created presidential seal.

Once the lettering was thermographed onto the paper, persons examined each stack of invitations and passed them along to the weighing machine. One stack was placed on the precision scale and a "217" flashed on the read-out, the number of invitations in the stack. "It has to be exact," Chase explained.

It took one of the company's engravers nearly 20 hours "all by eye" to complete the presidential seal which appears at the top of each sheaf. The lettering on the invitation, produced by a technique called "thermography," rather than traditional engraving, was all hand done as well, in delicate cursive.

Employees were on the telephone with Washington all day yesterday, and a large chart posting each day's deadline was posted. "Both places (Washington and Westboro) are chaotic," said Barbara Foster, in charge of sales for Chase.

In addition to the [illegible]00,000 invitations, 400,000 envelopes and 400,000 "stiffeners" which will accompany the invitations to keep them crisp in the mail, must be finished. The "stiffener" also will be printed, explaining that the invitation is a commemorative edition.

Chase also is handling the other inaugural event invitations, including those for the inaugural ball.

Several years ago the company produced the programs for the Johnson-Humphrey gala, and "15 years later we have the real thing," Chase said.

The same engraver who worked on that program was responsible for the painstaking detail on the seal on Reagan's invitations — Wiltold Jurgilewicz, from Poland.

Shipments have been going out daily the past two days and will continue until the job is completed. Although the deadline is not until Friday "we'd have it done Thursday" if necessary, Chase said.

Ms. Foster said she believes she was able to convince the Inaugural Committee to choose Chase "because of price, speed, quality of work and all the intangibles ... that go into selling a product. It's being there at the right place and the right time too."

western union **Telegram**

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PMS ARTHUR E CHASE, FONE 7524651
CHASE PAPER COMPANY
WILL CALL
WESTBORO MA 01581

BT

ON BEHALF OF THE PRESIDENTIAL INAUGURAL COMMITTEE-1981, I WOULD LIKE TO THANK YOU AND YOUR STAFF FOR AN EXCELLENT JOB IN PRINTING THE INVITATIONS FOR THE INAUGURATION OF PRESIDENT ELECT RONALD REAGAN AND VICE PRESIDENT ELECT GEORGE BUSH. THE DEDICATION AND PROFESSIONALISM SHOWN BY THE EMPLOYEES OF THE CHASE PRINTING COMPANY IS VERY EVIDENT IN THE BEAUTIFUL PRODUCT YOU PRODUCED TO COMMEMORATE THIS HISTORIC

SF-1201 ([illegible])

western union **Telegram**

OCCASION. ONCE AGAIN THANK YOU FOR ALL OF YOUR EFFORTS
ROBERT J COHEN, DIRECTOR OF PURCHASING AND PROCUREMENT PRESIDENTIAL INAUGURAL COMMITTEE-1981
NNNN

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The CHAIRMAN. Mr. Chase, thank you very much. I thank the panel.

I just have one or two questions, and then we will go around the room here.

First of all, I think it should be pointed out that two of the programs that are being featured here in testimony, the SBIC program and the MESBIC program, are slated by the administration's proposal for being cut out completely. These are not programs to be transferred over to the Commerce Department, but rather to be eliminated entirely.

Point No. 2. Let's get to a matter that is continually raised in the rhetoric of the administration—the business that there are 14.5 million small businesses out there with only "X" number of loans. Let's put this in its proper context and compare apples with apples, which is that there are roughly 4.5 million small businesses that are out there seeking loans. That reduces your population considerably insofar as using that as a comparison to the number of loans that are handed out.

I emphasized that point in my opening remarks regarding competition. Mr. Carlson, you have given a very dramatic story as to Cray Research growing from nothing to being one of the great corporations of this country. In the interest, I might add, of truth in chairing hearings, I should say that I own 110 shares of Cray Research. [Laughter.]

One point I would like you to touch upon is that this is a very special niche, I gather, of the computer industry—the business of supercomputers. If I am not mistaken, it is not one that many businesses are into. I realize everybody is into the desktop computers, as I see all those advertisements all the time.

In terms of competition, how much is out there? Also in terms of competition, is this not one of the areas where we are going to be confronted in the future with substantial competition from the Japanese?

Mr. CARLSON. Mr. Chairman, your analysis is correct. I talked only about the competition that was facing us in 1975.

First of all, to explain, supercomputers essentially are a special niche. The computer that we make is designed to simulate physical phenomena. We do not get involved in what I would call commercial data processing. Therefore, we are not in a niche that would be competitive with IBM or the compatible companies.

To give you an example of simulation of physical phenomena, some of our customers are aerospace companies—Boeing, the Lockheeds of the world. Boeing used the Cray computer to develop the 757 and 767's. Weather centers are using the Cray computer to make weather forecasts. It is used in the simulation of any type of physical phenomena. Automobile companies are using the Cray computer to design new automobiles. General Motors and Ford, for example, have recently acquired our machines.

About 24 months ago there was a lot of rhetoric in the press because the Japanese announced their supercomputers. Particularly, there are three Japanese companies who have announced intentions of developing and marketing supercomputers: Fujitsu, Hitachi, and NEC.

The initial reaction was that they probably would do to the supercomputer industry what they had done to the electronics and automobile industries. However, because of that, through an initiative from the National Science Foundation, money has recently been appropriated to establish supercomputer sites in the United States, and an attempt is being made to make sure that the supercomputer industry in the United States survives.

At Cray Research we are devoted to spending 15 percent of all of our revenue dollars to research and development activities. Supercomputer has been described as a necessary industry for the benefit of the United States, and our continuing leadership in that role is important.

The CHAIRMAN. Thank you very much.

My last question is this, and then we will go around the room. It is not a question but a statement, an addendum to my comment that both the SBIC Program and the MESBIC Program would be eliminated under the administration's proposal. I also want to make clear that so would the handicapped and other loan programs be eliminated by virtue of the administration's proposal. Everybody on this panel insofar as the origins of their success, both as to tax paying and employment—there is nothing for your successors by virtue of what is being proposed by the administration at this point.

Now we will go around the room with questions.

Senator Kasten.

Senator KASTEN. I just would like to ask unanimous consent that my opening statement be allowed to be presented in the record at an appropriate place.

The CHAIRMAN. It will be included in the record in its entirety at the outset of the hearings.

Senator KASTEN. Thank you very much.

The CHAIRMAN. Senator Nickles, do you have any questions?

Senator NICKLES. Just a quick question, Mr. Chairman.

Mr. Carlson, and really this is addressed to all of our panelists, I congratulate you on your success stories.

Mr. Carlson, with your SBIC, how much of the total financing initially to get your company going came from SBIC's?

Mr. CARLSON. The amount of money that came in prior to the public offering in 1976 was roughly $8 million. Of that, $1.8 million came from SBIC's.

Senator NICKLES. Twenty-some percent?

Mr. CARLSON. Roughly, yes.

Senator NICKLES. As SBIC works, did the SBIC have an equity portion of your company of 20 percent?

Mr. CARLSON. No. Initially, in 1975 the financing came through the form of convertible subordinated debentures, and we paid interest on those debentures of 8 percent until they were converted in 1978 to common stock or equity.

Senator NICKLES. So does SBIC have that equity position today?

Mr. CARLSON. Well, some do and some don't. The leader that I talked about, which was Northwest Venture Capital out of Minneapolis, Mr. Zikerelli's operation, still has a substantial amount of their original investment. That is what I was alluding to when I said they put in $2. That is their cost basis for the stock that they own today, and our stock closed yesterday on the New York Stock Exchange at around $70 a share. That is the return for a 10-year period.

Senator NICKLES. They still have that equity position?

Mr. CARLSON. They have some of it. I cannot tell you specifically how many shares they still own of their original position.

Senator NICKLES. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Sasser.

Senator SASSER. Thank you.

Mr. Chairman, as an original cosponsor of S. 408 legislation which will keep the Small Business Administration alive, I wish to commend you for holding these hearings today. These hearings are particularly timely, given the President's request to abolish the Small Business Administration and Mr. David Stockman's recent remarks slandering the agency and many in the small business community.

Mr. Chairman, I, like many of my colleagues today, have a number of conflicts. I have never quite been able to determine how you can be in more than one place at one time. However, we seem to continue to make those demands on ourselves here in the Senate. As I sit here at this moment, I have three other additional committee meetings going on at other places here on the Hill. Therefore, I am going to have to excuse myself. I did want to come by here this morning, Mr. Chairman, and indicate by my presence my support for SBA, and my support for your efforts on behalf of the small business community of this country.

I ask, Mr. Chairman, that my full statement be printed in the record as if read.

The CHAIRMAN. Thank you very much, Senator Sasser.

I would like to ask Mr. Lewis and Mr. Chase—Mr. Lewis, I gather from your testimony that you were not able to get all the financing that you required in the private sector. Is that correct?

Mr. LEWIS. That is correct.

The CHAIRMAN. In other words, it was not a question of not trying? I gather that you tried to do what you could in getting financing from the private sector. They did not come up with what was needed; is that correct?

Mr. LEWIS. At the time that we sought financing for the magazine back in 1969-70, we put a packet together. We were trying to raise $1,500,000. We opened our doors with $130,000. That money came from several SBIC's, several MESBIC's, several banks. However, the money, in and of itself, came from the banks in small packages, $30,000 apiece. That money, from the standpoint of how one gets into the magazine business, is not the kind of money one would need today, for example, if one were going to start a prototype Essence, because of what has happened economically in the publishing business. The economics of publishing have changed dramatically since the day we opened our doors. Therefore, it would take considerable amounts of moneys these days.

My concern is, when you say that the decision by the administration to eliminate or terminate MESBIC's and SBIC's, I'm not so sure that the other venture capitalist organizations that are committed to high tech investments are going to be as sensitive to consumer good possibilities or service-type companies that may come along who have ideas who would like to create opportunities.

The CHAIRMAN. I think the point you make is well made because, indeed, in attending the gatherings of the SBIC's and the MESBIC's, they have said much the same thing. So much of the money is dedicated to the high tech areas.

Mr. LEWIS. Yes.

The CHAIRMAN. It is far more difficult in the more mundane areas to go ahead and get financing.

Mr. Chase, you made a point that Mr. Carlson made. The two of you were very similar in one way and I wonder if you could just comment on it. It is basically that you first established yourself, but it was not until later on in the financing cycle that you turned to SBA. I believe much the same point was made here, where your first two tiers of financing went along OK but then, when you had to get to that third tier, that is where you really needed the SBIC help. You indicated you had been going for a while on a "treadmill," was the word I believe you used——

Mr. CHASE. Yes.

The CHAIRMAN [continuing]. Until you turned to the SBA?

Mr. CHASE. We had gone for 20 years in business and increased our sales from $25,000 the first year up to $500,000, and that was over a 20-year cycle. So we were growing steadily but very, very slowly. I don't think we would have been able to continue very much longer because we could not support the increased accounts receivable that we had to carry, the increased inventory that we had to carry, and the added equipment if we were going to stay in business.

The only way that we could have succeeded was to be able to get that injection in capital that would give us the money for an inventory that was not a good inventory as far as security was concerned, and for the really highly specialized electronic typesetting equipment that was necessary if we were going to be able to compete in the marketplace.

We were able to grow to a point on our own, but in order to go to the next step, it would have been impossible. The growth of the company was accelerated at a tremendous rate with that small injection of the capital that we were able to get.

The CHAIRMAN. Senator Bumpers.

Senator BUMPERS. Mr. Chairman, I would just comment that every one of the programs—let me put it this way: every one of the programs that has made every one of these gentlemen's companies successful is scheduled for elimination, not transfer.

The CHAIRMAN. Are there any other comments that the panel wishes to make at this time?

[No response.]

The CHAIRMAN. You should know, as Senator Bumpers mentioned at the outset—and I was going to bring much of this up in the course of the dialog which was to be between Mr. Stockman and the committee—that the bill that Senator Bumpers and I have introduced in no way represents the status quo. Indeed, under the leadership of James Sanders, the Small Business Administrator appointed by President Reagan, the Small Business Administration has not been status quo, nor has the activity of this committee been status quo. We have tried to address ourselves over the past several years to the problems that have existed in SBA, trying to put it into lean shape, trying to make its activity more meaningful, trying to get it out of the political loan area. Between the executive branch and the legislative branch, I think we have done a fair job.

However, when you come here and tell us about your particular successes in terms of providing jobs, in terms of bringing back to the U.S. Government more than was ever invested in you, in terms of providing competition, I think it makes very clear that there is still very much of a mission for the Small Business Administration.

As I indicated—again, I don't want to gloss over this in the course of my remarks—philosophically, you may or may not agree with the administration's policy; I may or may not agree with it, but clearly the administration's activity has been diminishing insofar as the Antitrust Division of the Justice Department is concerned. It is clearly diminishing insofar as the Federal Trade Commission is concerned.

I don't worry about that. I might disagree with it, but I don't worry about it as long as there is competition out there. I will tell you, I don't want to see the Antitrust Division and the FTC and the Small Business Administration all go down the chute, because, believe me, then it becomes a very predatory situation. I think I understand what that all leads to—just a few big fellows being left on the scene.

If you think that there is a cost to the Small Business Administration, all you do is just leave a few fellows out there on the scene and find out what the cost is.

Senator NICKLES. Mr. Chairman.

The CHAIRMAN. Senator Nickles.

Senator NICKLES. I wonder in your scheduling of the next hearing with Mr. Stockman if it might be possible to also have Mr. Sanders testify. One of the things that came out in this Oklahoma hearing was the amount of money that is going into disaster loans which was suggested might be more appropriately in Farmers Home, Agriculture particularly, disaster assistance, or maybe possibly under FEMA or something. I wonder if we might consider asking Mr. Sanders so that we can ask him about some of these programs.

The CHAIRMAN. No. 1, I would be delighted to have Mr. Sanders here, and he will be here, Senator, for you to ask any questions that you deem appropriate.

However, I want to make one point because it is a very sore point with the chairman. This committee worked long and hard to get farm disaster loans out of the Small Business Administration. We were successful, and so these loans were no longer in the Small Business Administration. Then a year ago this Senate, at the request of this administration, over the objection of this chairman and most of the members of this committee, and over the objection of Mr. Sanders, got farm loans back into the Small Business Administration.

I realize that there is agreement and disagreement within the committee itself, but I want to make very clear both as to where this chairman and the Administrator have stood on that issue——

Senator NICKLES. OK.

The CHAIRMAN [continuing]. Which is that it did not belong in the Small Business Administration. I know Senator Bumpers feels differently, and, indeed, many of the other Senators feel differently. I do not want to use my words to say what it is that they do or do not stand for. I did want to make that point clear because it is a big piece of money, and Mr. Stockman is the one that can take the responsibility for that piece of money being there.

Senator NICKLES. I would like to get into it again, since I have been hearing a lot about that from our State. Both Mr. Stockman and Mr. Sanders have some input on that issue.

The CHAIRMAN. Yes, absolutely.

Senator NICKLES. Thank you.

Senator BUMPERS. Mr. Chairman, if I may make a couple of observations.

No. 1, on this farm thing, the reason I had to leave this committee meeting a moment ago was to attend a meeting of some of the farm State Senators. We, as you know, have been negotiating with the majority leader and the Department of Agriculture trying to resolve this problem of what we are going to do to try to help farmers. It is critical.

The point was made in the meeting a moment ago, just to put all the members of this committee on notice, that whatever we do for farmers through the Farmers Home Administration and the banks under the Guaranteed Loan Program, the point was made that SBA is fairly deeply involved in farm loans now, and a lot of the farmers who have SBA loans are in the same shape as those who have Farmers Home loans. So this committee is also going to have to at least make some kind of a personal commitment that we will do our very best through the SBA. Perhaps the administration can handle that part of it and we do not need to become involved.

The point is, whatever you are going to do for farmers is going to have to be equitable and available to farmers whether they have a loan with the SBA or the Farmers Home Administration.

The CHAIRMAN. I do not think there is any question about that. The committee will live up to its obligations under the law. Whether I like what was done, or whether I don't like what was done, I could not agree with you more. It all will be fulfilled in the sense of farm, nonfarm. Both will be treated absolutely equally.

I might add, coming from a nonfarm State, I think what is happening out in the farm areas of this country is a tragedy. Believe me, I need help from time to time in my urban areas, and I am more than glad to put the hand across the line and give help.

Senator BUMPERS. I keep reminding my friends from New York City that I was the only Southern Senator to vote to bail New York City out. [Laughter.]

Now we need a little reciprocity. [Laughter.]

Let me ask all of you gentlemen this one question: Have you been offered some price or other by bigger corporations for your businesses? I would think, Mr. Carlson and Mr. Chase, that some of the conglomerates and big people would be in your office almost daily trying to buy your businesses. Has that been the case or not?

Mr. **Chase**. I have had an offer to sell to a larger company, but I ended up selling my interest to my brother to keep it as a family-held corporation.

Senator **Bumpers**. Mr. Lewis.

Mr. **Lewis**. Yes, I have had offers to sell the company but the price has not been right. [Laughter.]

Senator **Bumpers**. You can be had, though, I take it? [Laughter.]

Mr. **Lewis**. No; as a fellow New Yorker, I thank you for helping New York. [Laughter.]

Senator **Bumpers**. My interest in that, just for whatever it is worth to you, was twofold. No. 1, I thought New York was worth saving. No. 2, the mayors of my State told me that if New York City went under, their bonds would probably go up 1 to 2 points. I think that was true. I think that was a legitimate argument from the municipalities of Arkansas—that once municipalities started going under, every city in the country would suffer as a result of that. That turned out well.

Mr. **Lewis**. Yes.

Senator **Bumpers**. That is the way I feel about farmers. Lockheed turned out well, Chrysler turned out well, and New York City turned out well. Even Continental Illinois apparently is going to make it. I want the farmers of this country to make it, too. I think our responsibilities are equally as great to them.

Senator Weicker was talking a moment ago about what will happen in this country with no enforcement of the antitrust laws and with the abolition of SBA. It is that the big will get bigger. Almost invariably the consumers in this country pay when that happens.

When you consider the fact, as I said earlier this morning, that 80 percent of all the new jobs in this country are created by small business—and it is true, SBA does not service all the 14 million small businesses in this country, but only a fraction of 1 percent of those. But you gentlemen this morning are living testimony that the fraction of 1 percent that we are helping and saving are making a monumental contribution not just to the employment problems of this country, but to the U.S. Treasury in numbers that are really staggering as a percentage of what it has cost the Government to help you, that small amount on the front end.

I applaud all of you. I admire you very much. I want to thank you personally for your appearance and your testimony here this morning.

The **Chairman**. Thank you all very much.

Mr. **Chase**. Thank you.

Mr. **Lewis**. Thank you.

Mr. **Jonas**. Thank you.

Mr. **Childs**. Thank you.

Mr. **Carlson**. Thank you.

The **Chairman**. The next panel will be Mr. Arthur Mitchell, senior vice president of Capital Bank & Trust Co. of Baton Rouge, LA; Mr. Robert McCormick, Jr., president and chief executive officer of the Stillwater National Bank & Trust Co. of Stillwater, and he is accompanied by Mr. Thomas Bennett, Jr., who is the executive vice president of the Stillwater National Bank & Trust Co.; and Mr. Bailey Barnard, chairman of the board and chief executive officer of the First Capital California Business & Industrial Development Corp. of San Francisco.

[Brief recess taken.]

The CHAIRMAN. We will now hear from the second panel. I would be delighted to have my good friend, Don Nickles, introduce the first witness.

Senator NICKLES. Thank you, Mr. Chairman.

On behalf of Senator Boren and myself, who is unavoidably detained working on the agriculture credit situation, and for the panel's information and that of our guests, we have been working on that situation all day yesterday and meetings are going on today. I hope, after conferring with Senator Bumpers, that we are getting close. I would optimistically say that we should have some resolution that should be positive for bankers as well as for farmers passed this year.

Senator Boren wanted to join me in introduction of two good friends of ours, Bob McCormick and Tom Bennett.

Mr. Chairman, I will admit a little bit of a bias, as you did with the previous panel. I have been a participant in their bank as a student at Oklahoma State University when I was a client of Stillwater National Bank.

Since Mr. McCormick has become president of that bank, it has grown from a $20 million bank in 1970 to presently having assets of over $166 million. He is also past president of the Oklahoma Independent Bankers Association and past president of the Independent Bankers Association of America. He has quite a reputation in the banking industry, certainly in Oklahoma. We are pleased that he is here today.

Joining him is Tom Bennett, his vice president of the bank and in charge of the SBA loan activities.

Stillwater National Bank has been the top volume SBA lender in Oklahoma for the past 4 years and the top volume SBA lender in our five-State region for the past 3 years. It is 1 of the top 20 volume lenders in the Nation for the past couple years under the SBA guaranteed loan program. It generated $6.8 million in SBA loans during 1984 and an estimated $10 million in fiscal year 1985.

During September 1984, Stillwater National Bank sponsored a statewide bankers conference entitled "SBA Guaranteed Lending" for Oklahoma banks. It was attended by over 160 bankers and accountants, just to show the interest in the program and the success that they have had in it.

I congratulate them, and I thank you, Mr. Chairman, for having them participate today.

The CHAIRMAN. Thank you very much, Senator.

Mr. McCormick.

STATEMENT OF ROBERT L. McCORMICK, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, STILLWATER NATIONAL BANK & TRUST CO., STILLWATER, OK, ACCOMPANIED BY THOMAS E. BENNETT, JR., EXECUTIVE VICE PRESIDENT

Mr. McCORMICK. Mr. Chairman, members of the committee, it is a great privilege for us to be here today.

We have submitted some written testimony, and we hope that you will accept it for the record.

I think that the major point we would like to make today is that we are here especially to ask the committee to make sure that the Small Business Administration is continued, particularly their guaranteed lending programs, which are the programs in which we have been most involved. We know that the guaranteed programs work, and we are very anxious for their continuation.

The reason why we got so involved in the SBA guaranteed lending programs basically was because we could see that our small business customers had such a desperate need. This particularly took place during 1980 and 1981 when interest rates were being increased dramatically. We were trying to find some way to protect our customers from these extremely high interest rates.

When we discovered that through the use of the Small Business Administration's guaranteed loan program we were able to fix rates for small businessmen and sell the guaranteed portion of those rates into the money market, we felt we had found a program that would be enormously powerful and would mean a great deal to small business owners. That is exactly what took place.

The first point we would want to emphasize is that the guaranteed lending program gives lenders an opportunity to give fixed rates to small businessmen that are not otherwise available. After all, small banks, who are small businesses themselves, I might add, and it should not be overlooked, are almost the sole source of credit for small businesses, if you will look at the statistics. Because we intermediate the market with deposits and with loans, it is almost impossible for us to make fixed rate loans unless we have a facility like the guaranteed lending program.

Second, the SBA guaranteed lending program facilitates the flow of capital in and out of markets to the benefit of small business owners. One of the things we have been able to do that we think is especially powerful—and my colleague will talk about it in some detail in a moment—is that we are able to make loans to small businesses, sell the guaranteed portion of that loan, usually up to 90 percent of the loan, in the national market to the pension funds and large insurance companies and other providers of funds that do not normally loan money to small concerns. By refunding those loans, the money flows back into the community to be loaned again, many times to people who are not participating in our SBA program. So it is a very powerful vehicle for a small bank to be able to pour capital into their community and to enhance that community's economic development.

I would like to add that the economic development that takes place adds jobs to our community. It gives people the opportunity to live other places than just those places where high tech is being developed. It gives people the opportunity to get into businesses that are not necessarily high tech in nature. After all, in places such as Stillwater, OK, a college community of some 50,000 people, we may not be able to develop super computers or some of the other things that the administration is so excited about. The everyday type businesses in the United States, in terms of providing goods and services, are generally provided by the small business sector, and the programs of the Small Business Administration are extremely important.

Last, I would like to share with you that as a result of the guaranteed lending program, we have been able to provide essential services in a small town like ours, many times, and in other small towns in Oklahoma, that would not otherwise be provided, whether it be a grocery store in a small town or a child care center or some of the other businesses that we have financed over the years.

The CHAIRMAN. Mr. McCormick, do you want to yield time to your associate now?

Mr. McCORMICK. I would like to pass the ball to Mr. Bennett.

STATEMENT OF THOMAS E. BENNETT, JR., EXECUTIVE VICE PRESIDENT, STILLWATER NATIONAL BANK & TRUST CO., STILLWATER, OK

Mr. BENNETT. My name is Tom Bennett.

As Mr. McCormick has said, we work in a small bank in a small town. Since we did not know if you would know where Stillwater, OK was, we have provided a map so we can illustrate.

The CHAIRMAN. I don't know where Stillwater is, but I sure know where Fort Sill, OK is. [Laughter.]

I spent 2 years of my life there.

Senator BUMPERS. If you were a razorback, you would know where Stillwater was. [Laughter.]

Mr. BENNETT. Senator Nickles' home is up here in Kay County, OK. We are here in Payne County, OK, in the north central part of the State. We are a small community of about 50,000 people.

Our participation in the SBA program, however, has not been small. We have generated about $20 million in loans over the past few decades, and the biggest part of that has been in the past 3 or 4 years.

As Mr. McCormick said in our written testimony, we have tried to illustrate some of the points that he made. I would ask that you consider those in your hearings.

I would like to draw your attention to some very important points as they affect our bank.

The first one that Senator Nickles would particularly appreciate as a small businessman is the fact that we are able to make fixed rate loans to small business people that are not available without SBA guarantees. We have many customers that borrowed money in the mid-1970's that were tied to floating rate loans, and as the rates rose very rapidly in the late 1970's, early 1980's, they already owed the money; it was not a question of, are we going to borrow or not; they had it. As the rates went up, they could not afford the payments. So we got involved in making SBA loans and fixing the rate on those loans so that they had a fixed payment and a fixed interest rate and something they would know they could afford.

In the past 3 years we have been able to fix that rate for 61 borrowers in our community. It is very important if rates rise again in the future as they have in the recent past.

The second point that we think is very important has been graphically illustrated by your last panel. That is that successful SBA borrowers far exceed the number of unsuccessful SBA borrowers. In our experience, out of the $20 million in SBA loans we have made, we have had only two defaults, and only one of those borrowers has cost the Government any money.

The taxes paid by these successful SBA borrowers and their employees far exceed the cost of the loans to unsuccessful borrowers and the defaults that arise out of that. In that sense, the SBA guaranteed loan program generates a positive cash flow for the Government. We think that is very important in light of your efforts to reduce the deficit.

The third point that we would like to really emphasize is that through the use of these SBA guaranteed loans in many of the rural communities—we are small but there are many smaller, Senator Nickles, as you know, in rural communities around our town—we have been able to make loans, as illustrated in our written testimony, in Enid, OK, for the only grocery store in town; in Perkins, OK, for the only day care center in town; and in other communities around to provide essential services with loans that we could not make without the SBA's guarantee, because if the loans defaulted and we had to liquidate the collateral, they would not be worth in a small community what the original intent was if the loan failed.

The fourth point, and I really believe it is the most important from our perspective, is something I would like to illustrate, if I may, with our map of Stillwater, OK.

Senator **Bumpers**. It is demeaning for a bank president to have to stand holding a microphone. [Laughter.]

Mr. **McCormick**. No, sir.

Mr. **Bennett** [indicating large map of Stillwater, OK]. Mr. Chairman, this is not a map with the measles. In fact, this map with a large number of red dots illustrates the number of SBA loans we have been able to make in our community. We make these loans and we turn around and sell them and get the money back to reloan again in our community.

The number of blue dots is loans to additional small businesses not guaranteed by the SBA but loans that we were able to make because we had our money back again. We have made the loans to the SBA customers; we sold those loans; we got our money back; we reloaned it to more customers. By doing this, these red and these blue dots represent small business loans that have been made in our community by our bank in the past 3 or 4 years. It has made a significant impact on our ability to build our own community with our own small businesses without having to rely on anybody else to build our town.

Senator Weicker, we think that this is a good illustration of the point that you made in your comments in introducing your bill—that this makes us able to gain access to important capital tools for the small businesses of our community. As a result, we have witnessed in Stillwater, OK economic growth, community revitalization, and job creation.

That is particularly important to me. I am a fourth generation resident of Stillwater. Yet, I did not grow up there. When my parents grew up, they had to leave town because there were no jobs. I have come back, and I want to make sure in Stillwater, OK, when my children grow up, there will be the opportunity to stay because there will be jobs. Through programs like the SBA, we are able to build our community and make that happen.

The SBA allows small banks and small business borrowers and the small communities frequently that they live in to do many things that they could not possibly do without the SBA. We very much encourage you to continue the program because it is good for small business and it is good for the country.

Thank you.

[The prepared statement of Mr. McCormick and Mr. Bennett follows:]

TESTIMONY FOR
THE COMMITTEE ON SMALL BUSINESS
THE UNITED STATES SENATE
FEBRUARY 21, 1985

by

ROBERT L. McCORMICK, JR.
PRESIDENT AND CHIEF EXECUTIVE OFFICER
STILLWATER NATIONAL BANK AND TRUST COMPANY
STILLWATER, OKLAHOMA

and

THOMAS E. BENNETT, JR.
EXECUTIVE VICE PRESIDENT
STILLWATER NATIONAL BANK AND TRUST COMPANY
STILLWATER, OKLAHOMA

Mr. Chairman, my name is Robert L. McCormick, Jr. I am President of the Stillwater National Bank in Stillwater, Oklahoma. Our bank, with $168,000,000 in assets, is located in a community with approximately 50,000 residents. In addition to being the home of three major educational institutions and four large industries, we are the home of a thriving small business and professional community.

My colleague and I have come here today to ask you and your committee to continue the guaranteed lending programs of the Small Business Administration. As one of the top volume SBA lenders in the country, we have experienced the many benefits of the SBA guaranteed lending program in our community. We are currently participants in the SBA Certified Lenders program, and we have been recommended to be Oklahoma's first "Preferred Lender".

We ask you to seriously consider the following points in determining the fate of the Small Business Administration:

1. The SBA guaranteed loan programs provide small business lenders the positive option of providing long term fixed rate loans to small businesses which are not available without SBA guarantees. As a result of the deregulation of rates paid by banks on savings and time deposits, since 1978, the sources of funds available to finance small business have become short term in nature. Therefore, banks are reluctant to make long-term, fixed-rate loans to small businesses unless the banks can sell these loans to other lenders. This is only possible by use of SBA guarantees and the secondary market system.

2. The SBA guaranteed loan program serves to correct market failures which exist in our free enterprise economy. The development of the secondary market for the sale of SBA guaranteed loans has allowed small businesses, small banks, and small communities access to national credit markets that are otherwise unavailable. This process provides for the efficient redistribution of our nation's available capital. It allows funds from areas of capital surplus to be reallocated to communities in need of capital, without passing the credit risk of one community's growth back to the area providing the funds. Without the SBA guaranteed loan program and the secondary market application, these national capital markets will not be available to small businesses and small communities of our country. In that sense our free market will have failed to provide equal access to capital to all parties, and the system will be inefficient.

3. Through bank's making of SBA guaranteed loans and selling them to other lenders, the pool of available funds is significantly increased in the community where the loan has been made. As a result, the availability of SBA guaranteed loans is important to all small business borrowers in a given community, whether or not they receive an SBA guaranty of their loan.

4. The vast majority of businesses financed by SBA guaranteed loans become successful businesses. The taxes paid by these successful businesses and their employees far exceed the cost of losses

sustained by the government in unsuccessful business ventures. Therefore the program results in a net positive cash flow to the government and serves to reduce the federal deficit rather than serve as a cost to the government.

Furthermore, the successful small business is a critically important source of new jobs for our economy. According to Senator Weicker's testimony, 100% of all net new jobs between 1980 and 1982 were provided by small businesses. Thus, the Small Business Administration's guaranteed lending program also contributes to reducing the deficit by helping new and expanding small businesses create new jobs and thus new tax payers, who no longer must be an expense to the government as unemployed workers.

5. Contrary to information provided to your committee by Mr. Stockman, the rapid growth in venture capital investments, which is in fact evident in the high tech and pharmaceutical industries, is not a realistic source of capital for the mainstream small businesses of mainstreet America. Venture capitalists other than those venture capital companies created by the various SBA programs are not interested in and are not available to the vast majority of the small businesses of our country. These businesses must grow from their own individual resources and loans from their local banks. The SBA guaranteed loan programs, when used by local banks, provide long term repayment programs at lower interest rates than would otherwise be available to small businesses. In most cases, these loans would not be made at all without the SBA's guaranty.

6. Finally, the SBA guaranteed loan program allows banks to make loans for essential services in rural communities that would not be provided without the SBA's guaranty. These loans for such important services as grocery stores, child care centers, and pharmacies contain higher risk than commercial lenders can accept without an SBA guaranty. This is due to the fact that if the businesses do not succeed there is not a secondary use for the facilities financed that is of equal value to the purpose intended. However, without these services, the quality of life in many rural communities would be substantially reduced.

Mr. Chairman, my name is Thomas E. Bennett, Jr. I am the Executive Vice President in charge of lending at the Stillwater National Bank. I am honored to appear here today to address you; my fellow alumnus of Bethesda-Chevy Chase High School in Maryland, Senator Boren; my former college classmate at Oklahoma State University, Senator Nickles; and the other distinguished members of your committee and staff.

1. Over the last two decades our bank has generated nearly $20,000,000 in SBA guaranteed loans. These loans have resulted in only two defaults and only one loss to the government in the amount of $80,000. Conversely, these borrowers have paid to the government nearly $200,000 in guarantee fees. In addition, untold millions of dollars in taxes have been paid by these borrowers and their employees.

   In preparation for this testimony, we surveyed a broad spectrum of our SBA borrowers to provide data to illustrate this point. Of our 68 active borrowers 10 responded to our survey. These borrowers who collectively have $2,138,400 in SBA guarantees outstanding reported to us that in 1983 their employees paid $277,909 in Federal withholding taxes and that their businesses paid $75,756 in Federal income tax. This total of $353,665 in Federal taxes represents 16.54% of the amount of dollars which the government has at risk on loans to these borrowers. Even if the loans were in fact 100% grants, the government would enjoy a six year payback on its investment from tax receipts paid by these borrowers and their employees.

   I cannot over-emphasize the fact enough that zero government dollars has actually been spent or invested in these loans. Unless some of these borrowers fail and the sale of collateral pledged to secure their loans is insufficient to repay the debt, no government money will ever be spent or invested in these loans. Our bank provided the money to finance these loans. In most cases, our bank sold the guaranteed portions of these loans to other investors. What the government has done, at this time, is to guarantee that if the borrowers do not repay their loans that the government will.

   A vivid example of this point is a $500,000 ninety percent guaranteed loan made by our bank to Electronic Systems Engineering Company in Cushing, Oklahoma in 1981. Through the SBA's 90% guaranty, the Federal government has been at risk for $450,000 for the last four years. During that same period of time the employees of ESECO have paid to the Federal government $453,428.11 in taxes. Even if the guaranty had been a grant, the government would now be ahead merely on the taxes paid by ESECO employees. While we realize that in fact the government provided a wide range of services to the employees of ESECO, neither was the loan a grant. In fact, the loan has been reduced to $377,000 and ESECO is currently one of the major employers in Cushing, Oklahoma.

2. In the past three years our bank has made $15,400,000 in SBA guaranteed loans to 76 borrowers. We were able to arrange long-term, fixed-interest rates on the loans of 61 of these borrowers. This will be critically important to the success of these borrowers if interest rates rise in the future as rapidly or to the heights that they did in the early 1980's.

Our experience from the early 1980's taught us that when small businesses already owe money tied to floating interest rates, the payments can quickly become more than small businesses can afford when the rate rises. Exhibit A illustrates the actual experience in terms of change in payments on a $100,000, ten or twenty year loan, at New York Prime adjusted quarterly in the late 1970's and early 1980's.

The point is that many small businesses who borrowed money at floating interest rates in the late 1970's faced payments twice as large as they had anticipated within 2 to 3 years because of the rapid rise in interest rates. Those of you who are small businessmen know how devastating this experience was to the borrowers involved. Those of you who are not, can imagine the effect by visualizing this type of change in your monthly house payment.

3. Our bank currently has over $9,000,000 in SBA guaranteed loans sold into the secondary market. The map behind me is a 1984 map of Stillwater, Oklahoma. On it you see in red highlight the projects financed by SBA guaranteed loans. Also, on this map you see many other projects highlighted in blue. These blue highlighted projects represent the other non-SBA small business projects which we have been able to finance by increasing the total funds available in our community through selling the guaranteed portion of SBA loans into secondary markets. As noted in the attached letter from our Chamber of Commerce, the net result has been a vibrant growth in our small business and professional communities.

4. Our bank has sold our SBA guaranteed loans to a wide variety of lenders in a variety of geographic areas. At this time the providers of funds for the growth of our community from our sale of SBA guaranteed loans are as follows:

Connecticut	$340,000
Iowa	139,000
Virginia	376,000
Ohio	98,000
Louisianna	53,000
Indiana	62,000
Kansas	894,000
Tennessee	982,000
California	276,000
Minnesota	31,000
Arkansas	786,000
New Mexico	100,000
Washington	80,000
New York	73,000
Illinois	363,000
Texas	713,000
New Jersey	153,000
Bradford Trust	628,000
Oklahoma	2,880,000
Total	$9,208,000

While these investors have provided funds for the growth of our community, none of them have funds at risk due to the SBA's guaranty. These funds would not have been available to build our community if it had not been for our ability to sell the SBA's guaranty.

5. As you undoubtedly will find to be the experience of other states, there are many towns in Oklahoma which have been extremely well served by the guaranteed lending programs of the SBA. If your time allowed and transportation could be made available, you would do well to invite representatives of a cross section of cities and towns that have had their major businesses started or essential services provided by SBA guaranteed loans.

I would like to relate three of these Oklahoma examples to you:

a. The major employer of Noble County, Oklahoma is a company by the name of Charles Machine Works. Their product is known worldwide by the trade name of Ditch Witch. In the late 1950's, Ed Malzahn, president of Charles Machine Works was unable to acquire working captial to build his business without an SBA guaranteed loan. As his business became successful, he needed a second SBA guaranteed loan to build the company's first plant in Perry, Oklahoma. Today, the loans have been paid in full for over twenty years, and "Ditch Witch" employes over 700 workers. The company would probably not have been started or expanded without the SBA.

b. In early 1984 the owner of Arnett Grocery Store died. This was the only grocery store in this rural community of 800 people. The local bank in Arnett was not big enough to make a $105,000 loan for new owners to purchase the store. Our bank, through the use of the SBA's guaranteed loan program, was able to arrange financing of the store. Without this financing the residents of Arnett would have had to drive over fifteen miles to a neighboring community to acquire groceries for their families. This would have meant serious hardship for the people of Arnett, and possibly the future demise of the town. There is no question that this loan would not have been made without the SBA's quaranty.

c. As the town of Perkins, Oklahoma grew in the late 1970's, the community's only day care center reached its capacity. Funds were needed to purchase an old church building and refurbish it so that it would provide ample space for the care of many of the community's children while their parents were at work. According to Clayton Lancaster, owner of the center, "Local funding was not available to us. The SBA loan which we arranged through Stillwater National Bank, made it possible for us to purchase and renovate an unused church building. The expansion of our facility improved our ability to provide this essential service to our community. We were also able to provide additional jobs through our increased capacity."

Summary and Conclusion

The SBA guaranteed lending programs have been vitally important to the growth of our customers, our bank, and our community. Without the SBA:

- Many new business in our community would never have been started,
- Many existing businesses would not have been able to expand,
- Many employees of new and expanded existing businesses would either be out of work in Stillwater, or they would have moved to other communities in search of jobs,
- Many services that significantly raise the quality of life in our community would not have been made available to our citizens,
- Many of our citizens would be forced to drive to major metropolitan areas to acquire goods and services that they can now purchase in Stillwater,
- Many old buildings in our community would continue to be deteriorating rather than having been remodeled and refurbished into beautiful, almost new facilities,
- Many of our borrowers would have had to borrow money that would have to be repaid over several years at floating interest rates without any assurance that the rates would remain at a level which they could afford,
- Many businesses in our community would have been unable to computerize their operation or purchase new and more efficient equipment and thus either the services provided to our citizens would have been of lower quality or these local businesses would have failed as they tried to compete with large businesses who use computerized modern equipment to reduce the cost of their products and services,
- Many dreams that have become reality today would still be dreams or might have turned to bitterness at their lack of realization.

Attached as a portion of our testimony are the following items:

1. Letters from some of our SBA borrowers which substantiate the points we have made in our testimony.
2. Copies of the article, "Helping Entrepreneurs Through SBA Lending by Community Banks", October, 1984 The Journal of Commercial Bank Lending, authored by Thomas E. Bennett, Jr. which explains our reasoning for being SBA lenders and our program for making SBA guaranteed loans.
3. A summary of the degree of lending problems facing ther banks of Oklahoma, followed by a summary of the loan losses suffered by the SBA in Oklahoma. Both have been too high, but they are both related to the extreme depression that currently exists in two of Oklahoma's major industries: Agriculture and oil and gas. It is not appropriate to single out SBA and state that they are facing record losses, without equally observing that the entire banking system is facing its worst losses since the the '30's.

We echo the words of Chairman Weicker, regarding the SBA, "These are programs that effectively utilize private sector resources and expertise. This public/private partnership allows small firms to have access to capital, otherwise unavailable. By opening these capital pools to small business, we have witnessed economic growth, community revitalization and job creation." Mr. Weicker, we offer Stillwater, Oklahoma as an example to prove your point.

We urge you to embrace the challenges of Senator Bumpers, "First, be determined to do your fair share toward reducing the deficit" - realizing that the SBA generates more revenue for the government than it costs the government; and "Second, be equally determined that the SBA not be offered up as a sacrificial lamb in a meaningless gesture at reducing the deficit" - not only meaningless, but erroneous.

We encourage you to search each of your home states for the hundreds of examples throughout the country which prove that Senator Sasser was right when he said, "Through a variety of programs, the SBA offers valuable aid and assistance to a great many small firms which might otherwise go out of business or remain nothing more than the dream of a young entrepreneur" - we offer the examples of Ditch Witch in Perry, Oklahoma; ESECO in Cushing, Oklahoma; and Pente Games in Stillwater, Oklahoma.

As our Senators from Oklahoma celebrate each April 22, Oklahoma itself is a great example of the government working with small businesses and family farmers to get things started. On April 22, 1889, the territory of Oklahoma became a great enterprise zone as thousands of settlers raced across the starting line to stake a claim on their part of the American dream. The government did not offer Oklahoma off to the highest bidder or wait for the market to determine its destiny. The government helped the common ordinary people get started by staking a claim.

We ask you to continue the frontier spirit that started our great state. We ask you to continue this great program of entrepreneurial spirit that has helped to build our community. We heartily urge you to unanimously "Send a clear message to the President and to the country that you support small business, and that you support the SBA and its goals." Thank you for the opportunity to share our thoughts with you.

EXHIBIT A

ILLUSTRATION OF ACTUAL RATE CHANGE OF NEW YORK CHASE PRIME FROM 4-01-78 to 7-01-82 on $100,000 LOAN

Date	Prime	10 Year Amortization	20 Year Amortization	Interest Only
4-1-78	8.00	1,213.28	836.45	666.66
7-1-78	9.00	1,266.76	899.73	750.00
10-1-78	9.75	1,307.71	948.52	812.50
1-1-79	11.75	1,420.30	1,083.71	979.17
4-1-79	11.50	1,405.96	1,066.43	958.33
7-1-79	11.50	1,405.96	1,066.43	958.33
10-1-79	13.50	1,522.75	1,207.38	1,125.00
1-1-80	15.25	1,629.00	1,236.00	1,271.00
4-1-80	20.00	1,932.56	1,698.83	1,666.67
7-1-80	12.00	1,434.71	1,101.09	1,000.00
10-1-80	15.00	1,613.35	1,316.79	1,250.00
1-1-81	20.50	1,965.83	1,738.16	1,708.33
4-1-81	17.00	1,737.98	1,466.81	1,416.67
7-1-81	20.00	1,932.56	1,698.83	1,625.00
10-1-81	19.50	1,899.53	1,659.67	1,312.50
1-1-82	15.75	1,660.00	1,373.00	1,375.00
4-1-82	16.50	1,706.43	1,428.91	1,375.00
7-1-82	16.50	1,706.43	1,428.91	1,375.00

Most loans to small businesses are not made a prime. The following is the effective increase in monthly payments at the described "mark-up" over prime on a $100,000 loan.

% Over Prime	10 Year Amortization	20 Year Amortization	Interest Only
+1	+66.76	+78.82	+83.33
+2	+133.52	+157.64	+166.67
+3	+200.28	+236.46	+250.00

SUMMARY OF FINANCIAL DATA ON STILLWATER NATIONAL BANK & TRUST COMPANY

	1981	1982	1983	1984
*New Loans	71,997	74,107	86,987	107,322
Other Assets	36,344	54,387	48,688	58,653
Total Assets	118,341	128,494	135,675	165,975
Deposits	106,685	115,508	122,017	150,604
Other Liabilities	3,979	3,229	2,452	2,626
Stockholders Equity	8,678	9,757	11,206	12,645
Total Liab. Equity	118,341	128,494	135,675	165,975
*Total Loans Sold to Investors	14,603	18,858	31,343	43,477
-SBA/FmHA	4,703	4,684	9,768	12,669
-Mortgage Loans	9,900	14,174	21,575	31,708
Total Loan Funds Avail. to SNB Customers	87,870	94,237	119,422	152,679

ROBERT L. McCORMICK, JR.

May, 1984

EDUCATION:

Graduated from the University of Oklahoma with B.B.A. degree

EXPERIENCE:

Began banking career December 16, 1962, at Fidelity Bank, N.A. Oklahoma City, Oklahoma

Elected Assistant Cashier, January, 1964
- Assistant Vice President, June, 1964
- Vice President, January, 1966

Elected President of Stillwater National Bank and Trust Company, Stillwater, Oklahoma, August 17, 1970

ORGANIZATIONS:

Past President, Independent Bankers Association of America
Past President, Independent Bankers Association of Oklahoma
Member, Governor's Advisory Board on Productivity
Chairman, Mayor's Financial Advisory Committee, City of Stillwater
Member, Board of Directors, Stillwater Medical Center Foundation
Past President and Member, Board of Directors, Stillwater Family YMCA
Past Member, Board of Governors, Oklahoma State University Foundation
Past Chairman, Board of Trustees, Oklahoma State University Foundation
Past President, Board of Directors, Stillwater Downtown Development Corporation
Past President and Past Member, Board of Directors, Stillwater Chamber of Commerce
Past Vice President and Director, Stillwater Industrial Development Foundation
Past Member, Board of Directors, Oklahoma Bankers Association

PROFESSIONAL TRAINING:

Graduate, Senior Lending Seminar, Robert Morris Associates, Indiana University, 1971
Graduate, Seminar for Senior Bank Officers, The Institute for Financial Management, Harvard University, 1971, sponsored by the Independent Bankers Association of America

MILITARY EXPERIENCE:

1958-1962, Captain, United States Marine Corp Reserve

THOMAS E. BENNETT, JR.
EXECUTIVE VICE PRESIDENT
STILLWATER NATIONAL BANK & TRUST COMPANY

As Executive Vice President of lending at Stillwater National Bank and Trust Company, Thomas E. Bennett, Jr. manages a loan portfolio of over $150,000,000, which includes $15,000,000 in SBA guaranteed loans (nearly $12,000,000 sold on the secondary market). The bank has 24 lending officers with average banking experience of over 14 years.

At age 34, Tom Bennett has served the financial industry as:

- Executive Committee Member of the 1982, 1983, and 1984 Securities and Exchange Commission Sponsored Government Business Forum on Small Business Capital Foundation.
- Oklahoma Group Chairman of the Robert Morris Associates (The National Association of Commercial Loan and Credit Officers).
- Members of Two National Committees of the Robert Morris Associates, including their Legislative and Regulatory Committee.
- Author of four articles published in National Banking Journals including "Helping Entrepreneurs through SBA Lending by Community Banks", The Journal of Commercial Bank Lending, October 1984.
- Instructor at the Oklahoma Bankers Association sponsored Commercial Lending School and their Installment Lending School.
- Speaker at various State and National meetings and conferences including the National SBA Conference of State Legislators and Mayors.

Mr. Bennett has been recognized for his contributions to the financial industry by being named "The Oklahoma Small Business Advocate of the Year - 1985" by the SBA; and by receiving the Distinguished Service Award of the Robert Morris Association in 1983.

Mr. Bennett is a graduate of the Oklahoma State University and a variety of bank management and lending schools sponsored by the American Bankers Association, the Robert Morris Association and the Independent Bankers Association of America. He is active in a variety of community and state civic and charitable organizations.

the chamber
STILLWATER OKLAHOMA
Chamber of Commerce

P. O. Box 1687 • Stillwater, OK 74076 • 405/372-5573

February 19, 1985

Senator Lowell Weicker, Jr.
Chairman, Committee on Small Business
United States Senate
Washington D.C. 20510

Dear Senator Weicker:

The guaranteed lending programs of the Small Business Administration have been a very important factor in the vibrant growth of Stillwater, Oklahoma, during the last decade. Through the making of loans guaranteed by the S.B.A., by our local banks, and the sale of these loans to investors in other communities, Stillwater has been able to raise over $12,000,000 in new capital. This new capital has provided enhanced opportunities for the development of new businesses and new jobs in our community.

We encourage you and your committee to continue the guaranteed lending programs of the Small Business Administration. They are very important programs for the growth of small businesses and small communities in our country. The loans generated by Stillwater banks are a positive example of the program's effectiveness as evidenced by the increased capital available for new businesses and by the increasing local, state, and national tax base.

Sincerely,

Trish Houston

Patricia Houston
President

PH:mlm

ACCREDITED
CHAMBER OF COMMERCE
CHAMBER OF COMMERCE OF THE UNITED STATES

Ron Shirley Pontiac - Buick - GMC, Inc.
4700 West Sixth Stillwater, Oklahoma 74074

BUICK
GMC
TRUCKS

February 12, 1985

To Whom it May Concern,

The SBA Loan Guarranty Program allowed Ron Shirley Pontiac-Buick-GMC, Inc. to go into business at a most unfavorable time. In January 1981, when we started business, interst rates were at an all time high. Without the lower interest rates that the SBA offered, and Stillwater National Bank's interest in helping arrange favorable financing, our company would not exist today.

The most important factor in our particular case is the amount of income produced. We had a payroll in 1984 in excess of $500,000.00. We also sold over 700 vehicles which produced over $300,000.00 in license and tax income for our state and community.

In short, tax revenue created by our company is over three times greater than the total SBA loan itself. This is only one year, 1984, so the existance of this SBA loan has a lot more merit, than most people can imagine.

Respectfully,

Ron Shirley

GREINER & FRANKLIN
CERTIFIED PUBLIC ACCOUNTANTS
919 S. MAIN, SUITE A
STILLWATER, OKLAHOMA 74074
(405) 624-0414

STEVEN A. GREINER, C.P.A.

GARY N. FRANKLIN, C.P.A.

February 19, 1985

Senator Lowell Weicker, Jr.
Chairman, Committee on Small Business
United States Senate
Washington, DC 20510

Dear Senator Weicker:

My partner and I began our accounting partnership in 1977 here in Stillwater, Oklahoma. Over the years our practice has grown from one initial employee to six today. Prior to 1983 we rented office space in local buildings to house our practice.

In 1983 we decided to acquire an old building located in Stillwater's central business district. We were able to arrange an SBA guaranteed loan through Stillwater National Bank to purchase and improve this building.

Through receiving this loan, we have significantly enhanced the quality of the building in our community's downtown area and we have provided room to expand the operations of our practice.

We recommend that you continue the SBA guaranteed loan program. Through its use, we have been able to improve the quality of our community's central business district without tying up a significant amount of our community's capital, by virtue of the fact that Stillwater National Bank sold the guaranteed portion of our loan. We believe that this program is an effective means of improving rural communities and improving the efficiency of the general credit markets.

Sincerely,

Steven A. Greiner

Steven A. Greiner
Partner

SAG/dah

Stillwater Credit Bureau, Inc.
P. O. Box 1448 116 West 8th
STILLWATER, OKLAHOMA 74076-1448

CREDIT
REPORTING
DIVISION
372-7270

COLLECTION
SERVICE
DIVISION
372-1693

February 19, 1985

Senator Lowell Weicker, Jr., Chairman
Committee on Small Business
United States Senate
Washington, D. C. 20510

Dear Senator Weicker:

By year end 1982 the Stillwater Credit Bureau, Inc., which had operated successfully since 1927, was experiencing increasing difficulty competing with large computerized corporations in the consumer credit industry. Our manual maintenance of files and records made our costs for delivering services to our customers much higher than those of our large business competitors. If we had not been able to computerize our business we would have been forced to sell or liquidate our business, resulting in the loss of thirteen jobs in our community.

Through an SBA guaranteed loan arranged by Stillwater National Bank, we were able to make the conversion from a manual to a computerized system. In addition, we were able to acquire a fixed interest rate of 12.75% on our seven year term loan. A loan at this rate for this term would not have been available to us without an SBA guaranty.

As a result of our being able to acquire this $80,000 SBA guaranteed loan, our business has resumed its historically steady profits. We have expanded our community services and we have maintained our staff of thirteen employees. These employees paid $13,940 in withholding taxes and $17,998 in social security taxes in 1983.

In addition we were able to improve the quality of consumer credit services available in our community. As a result of our higher quality service the banks in our community are better able to make prompt and efficient loan decisions, thus pyramiding the value of our SBA guaranteed loan.

"Serving the CONSUMER, the CREDITOR, and the COMMUNITY Since 1927."

Senator Lowell Weicker, Jr.
February 19, 1985
Page 2

I highly recommend that you continue the SBA loan guaranty program. It has been good for our business, our community, and our country.

Sincerely,

Larry A. Plank,
President

LAP/cw

W V H

Western Veterinary Hospital
JOHN CHITWOOD, D.V.M.
(405) 743-2800 / 2315 West 6th / Stillwater, OK 74074

February 19, 1905

The Honorable Lowell Weiker, Jr.
Chairman, Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Senator Weiker:

In August of 1983 my wife and I were seeking funds to purchase and remodel a service station into a modern veterinary hospital.

The federal government's guarantee to cover ninety percent of the loss, in case of default, through The Small Business Administration allowed us to obtain a fixed rate mortgage instead of a variable rate mortgage.

The interest on this loan has cost us 38.81% of the gross sales for the first nine months of operation. It is obvious we would default with an increasing variable rate mortgage.

Sincerely,

John Chitwood DVM

John Chitwood, DVM
Owner

North
Western
Highway 51 West
6th Street to Hwy 51

THE STILLWATER NATIONAL BANK AND TRUST COMPANY

At year end 1984, the Stillwater National Bank and Trust Company was a $166 million bank with: $107 million in net loans (plus $45 million sold into the secondary market), $151 million in deposits, and stockholder's equity of $12.6 million. In 1984 the bank earned a net profit of $2,018,742 or 18% on stockholder's equity. The bank experienced net loan losses of $696,806 representing a .7% loss on the bank's average loan portfolio (as compared to the average Oklahoma bank's losses on loans of 1.74% in 1983).

The Stillwater National Bank and Trust Company has been an active participant in the guaranteed lending programs of the Small Business Administration. The bank has been an SBA lender for nearly two decades. It has been a high volume SBA lender since 1981 and a certified lender since 1982. As such, Stillwater National Bank has been the highest volume SBA lender in Oklahoma each year since 1981 and has been one of the top 20 volume SBA lenders in the country for the last 2 years.

During Stillwater National Bank's SBA lending experience nearly $20,000,000 in guaranteed loans have been made to the bank's small business customers. Only two of these loans have resulted in defaults and only one loan resulted in a loss to the government in the amount of $80,000. Conversely the government has collected nearly $200,000 in guaranteed fees and untold millions of dollars in taxes from these successful SBA borrowers and their employees.

In March of 1984, Stillwater National Bank and Trust Company opened a loan production office in metropolitan Oklahoma City, Oklahoma, which specializes in SBA and mortgage lending. In March of 1985, the bank will open a similar office in Tulsa, Oklahoma. The bank has found substantial interest by borrowers in both communities in pursuing SBA guaranteed loans. At this time the bank has 22 SBA loan applications in process which if all approved will total nearly $5,000,000 in loans.

In September of 1984, Stillwater National Bank and Trust Company sponsored a conference for Oklahoma bankers on SBA lending. This conference, attended by representatives of both Senator Boren's and Senator Nickle's offices, drew a crowd of 160 bankers from across the state. Both at that conference and since then many bankers in Oklahoma have shown increasing interest and participation in the SBA Loan Programs.

Increase
Your Profits
with
Small Business
Administration
Guaranteed
Loans

*Learn the success strategy
developed by
Stillwater National Bank,
the top volume S.B.A. lender in
this five state region.*

SEMINAR:

"SMALL BUSINESS ADMINISTRATION GUARANTEED LENDING FOR OKLAHOMA BANKS"

Learn first hand from S.B.A. officials and from Stillwater National Bank's Commercial loan officers as they share their strategies, techniques and experience.

— See agenda on back —

SEPTEMBER 27, 1984 • 9:00 A.M. TO 4:30 P.M.
SHERATON INN — STILLWATER, 4500 W. SIXTH, STILLWATER, OK
$35 FEE FOR ONE PERSON, $50 FEE FOR TWO
$20 EACH FOR ADDITIONAL PERSONS
Fee includes lunch and refreshments

FOR RESERVATIONS CALL
(405) 372-2230, Extension 261

STILLWATER NATIONAL BANK AND TRUST COMPANY
MEMBER F.D.I.C.
SIXTH AND MAIN • STILLWATER, OKLAHOMA

AGENDA

Small Business Administration Guaranteed Lending
For Oklahoma Banks
September 27, 1984
Stillwater, Oklahoma
Sponsored by The Stillwater National Bank and Trust Company

9:00 - 9:30	Registration - The Sheraton Hotel, Stillwater
9:30 - 9:45	Welcome and Opening Remarks - Robert L McCormick, Jr., President, Stillwater National Bank and Trust Company
9:45 - 10:30	"A Case for SBA Guaranteed Lending" - Thomas E. Bennett, Jr., Executive Vice President, Stillwater National Bank and Trust Company
10:30 - 10:45	Coffee Break
10:45 - 11:30	"SBA Lending Programs Available to Oklahoma Banks" - Jon Rice, Assistant District Director, Small Business Administration
11:30 - 12:00	Panel Discussion/Questions and Answers about What Works, Jon Rice - SBA Thomas E. Bennett, Jr. - Stillwater National Bank Anthony R. Wilkinson - V.P. in charge of Government Guaranteed Lending, Stillwater National Bank
12:00 - 1:30	Lunch - The Sheraton "Financial Industry Deregulation and our need for a variety of services - including SBA." - Robert L. McCormick, Jr.,
1:30 - 2:45	Workshop on How to Qualify SBA Applicants, How to Close, and How to Service SBA Loans - Louise Thompson - Commercial Loan Officer, SBA Jon Rice - Assistant District Director, SBA Dian Hardin - Assistant Vice President, Government Guaranteed Loans, SNB Anthony Wilkinson, Vice President, SNB
2:45 - 3:00	Coffee Break
3:00 - 4:30	"What Happens When Things Go Wrong" and "Buying or Selling SBA Guaranteed Loans" - Walt Dobry - Chief Portfolio Management Division, Small Business Administration Wanda Garrett - Paralegal Specialist, Small Business Administration Anthony Wilkinson, Vice President, Stillwater National Bank Robert L. McCormick, Jr., President, Stillwater National Bank

REGISTRATION FORM

Name: ____________________ Name: ____________________

Title: ____________________ Title: ____________________

Name of Bank: ____

Address: ________________________________ Zip: __________

☐ Payment Enclosed

☐ Bill Me

Fees: $35 for one person
$50 for two people
$20 each additional person

Mail completed form to:
STILLWATER NATIONAL BANK AND TRUST CO.
P. O. BOX 1988
STILLWATER, OKLAHOMA 74076
Attn. THOMAS E. BENNETT, JR.

The **Chairman**. Thank you, Mr. Bennett.

Senator **Nickles**. Mr. Chairman.

The **Chairman**. Yes, Senator Nickles.

Senator **Nickles**. I have been summoned to the agriculture meeting, but I would like to ask a couple really quick questions of our panelists.

The **Chairman**. You sure can.

Senator **Nickles**. You mentioned, Mr. Bennett, I think 2 defaults out of about 60 loans?

Mr. **Bennett**. Yes; we have made 76 loans in the past 3 years. We made $20 million in loans in total in the past two decades. We have had only two defaults, yes.

Senator **Nickles**. What percentage of the loans is that? Would you happen to know that?

Mr. **Bennett**. I do not know the actual percentage in the numbers of loans.

Senator **Nickles**. Just looking at the figure, though, you are talking about a small percentage of the number of loans and probably a very small percentage in the total loan volume.

Nationally, in looking at the default rate that came from OMB, they are talking about 19 or 20 percent. You are doing much better. Why?

Mr. **McCormick**. I would be happy to answer that. I think it is because we have a style of lending which has allowed us to be somewhat more successful than that style which is generally followed. It is related to our view that when you loan money to folks, even if the Government guarantees it, if you will, that you need to loan money to people who have training, that have education, that have experience, and to folks who have demonstrated a lifestyle in which they have some discipline, so that when you give them money they are going to use it appropriately.

Now they may not have capital. They may not have experience—a long pro forma demonstrated——

Senator **Nickles**. Better management practices——

Mr. **McCormick**. Right; by following that approach, it has made our program, I think, very successful. I think that is the underlying reason why.

Senator **Nickles**. I have another question, and then I am going to have to run. The meeting starts at 11 o'clock.

You are the biggest bank in a five-State region for generating SBA loans. You are really a small bank in comparison to the five States certainly. Why haven't more banks been more aggressive in this area as you have been?

Mr. **McCormick**. I think it is a difficult thing to learn and it is a difficult thing to do. One of the reasons why is because the Small Business Administration itself in terms of staffing is rather seriously underfunded, and it is very difficult for them to deliver services to the banking industry the way they are presently organized. It has really kept a lot of people from being able to participate in the program.

Mr. **Bennett**. Senator Nickles, I would also add that, as late as last fall, there were only four certified lenders in Oklahoma. There has recently been a fifth certified. Two have been added in the Precertified Lenders Program, which will take the number to seven.

As a representative from your staff and from Senator Boren's staff witnessed back in September, over 160 people came—bankers and accountants from across the State that are interested in SBA. There is a growing interest and a growing recognition of the need for SBA loans in Oklahoma.

Senator NICKLES. They are interested, but is it too difficult to become certified? Is it too much redtape? Most of the small bankers, are they saying, "Well, it's not quite worth it."?

Mr. BENNETT. Senator, I think it is a matter of timing. In order to get certified, you have to have a certain volume of loans and a good quality experience with the SBA before they will certify you. It is going to be a matter of time and being able to build that volume to get certified.

Senator NICKLES. Thank you very much, Mr. McCormick and Mr. Bennett.

Mr. Chairman, thank you, too, for having them participate in the hearing.

The CHAIRMAN. Thank you.

Just to follow up on the point, I met with some of my Connecticut bankers yesterday. We had representatives of the largest banks in the State in addition to the middle-sized and smaller banks. Even the fellows in the big banks admitted to the fact that most of the small business loan activity was handled by the middle-sized and small banks, not the big fellows.

This does not mean to disparage larger banks, but I think it is probably more of a case that you are closer to the community, and can make these human judgments, if you will, as to the basis for a loan.

I am very wary of bigness, and think that it might serve a particular purpose, but in another sense sometimes it can be very restrictive. That is why I was interested to hear your comments as to what your bank does. I suspect that in terms of what you do with small business, even though you are not the biggest bank in the State, probably in terms of small business you are one of the biggest banks in the State.

Mr. MCCORMICK. If I may, Mr. Chairman, one of the things that is taking place in our country is we are deregulating the banking business. As a result of that, we are going to get more concentration in banking as the larger banks acquire the small banks.

One of the reasons why we are in this program is we are looking around for strategies to try to survive that competition that we see coming with large banks. This SBA program is a very, very important resource to us, so that we can probably, we hope, be able to compete with the very large competitors that we are going to be faced with in the future.

Senator BUMPERS. You are not part of a bank holding company, Mr. McCormick?

Mr. MCCORMICK. No, we're not.

The CHAIRMAN. The next witness is Mr. Arthur Mitchell, senior vice president of the Capital Bank & Trust Co. of Baton Rouge, LA.

Mr. Mitchell.

STATEMENT OF ARTHUR J. MITCHELL, SENIOR VICE PRESIDENT, CAPITAL BANK & TRUST CO., BATON ROUGE, LA

Mr. MITCHELL. Mr. Chairman, Senator Bumpers, my name is Arthur Mitchell. I am senior vice president of the Capital Bank & Trust Co. in Baton Rouge, LA. I am here to offer testimony on behalf of the Independent Bankers Association of America—we represent some 7,800 banks nationwide—and also on behalf of Capital Bank. There I am involved with the SBA Guaranteed Loan Program and have been for the past 15 years.

I trust my testimony will be used as the basis for making a positive decision to retain the existence of the SBA and let it take its place among the other successful and viable Government agencies that have served the American public well.

In the latter part of 1970, Capital Bank was visited by the then-Director of the SBA in New Orleans and we were first introduced to the concept and the program of the Guaranteed Loan Program through SBA.

As we enter 1985, since that time, we have made 484 SBA loans under the 7(a) program, totaling some $77,692,780. Our bank has grown from a $74 million bank to a $540 million bank, and much of that we give credit to the SBA program to help us.

The primary reasons we have been so excited and have consistently used the SBA program—and, incidentally, what I am going to say is going to echo a lot of what they have said, and they say out of the mouth of two witnesses you can depend on it; we did not rehearse this—are that we saw it as a means of filling a need for the small businessman that is not being met and is still not being met today.

If you go to look for a small business loan—and I say "small," say under a half a million—you go for term financing to a life insurance company; they are not interested. They want something bigger than that. You go to the other basic source of long-term financing, which in our area is primarily the savings and loan industry. They understand apartments, they understand shopping centers, but they do not understand business loans. The small businessman has no other place to go but to the bank. If you are talking about long-term financing, because of the liquidity requirements on banks, our hands are tied unless we have a weapon to use. We feel that weapon, that tool, is the Guaranteed Loan Program.

By having the 90-percent portion or 75- or 80-percent guarantee, the ready access of a secondary market is available to us. If we make a $500,000, 20-year loan for somebody to build a facility, all we have to think in terms of liquidity is $50,000 because we know we can get the rest of our money back if we need to, and get it back very quickly.

An additional factor that I think is very important, and it has been touched on before, has to do with the job creations of these small business loans. That statistic is readily available because the application asks how many jobs are involved.

The 484 loans we made involved either created or sustained 6,559 jobs. Although we do not have current statistics as to what the employment is today, it is safe to say that those are substantially greater than that because of the business growth, and so forth.

It is unfortunate that whereas negative statistics have always been readily available concerning SBA, concerning the losses and business failures, there have been no statistics available to show its successes. We heard some of the stories here earlier. I picked out four, and naturally I picked out some of the best ones, but there are many others that are very good and many others that are very substantial.

In the first case, it was a retail establishment, and we loaned $90,000 to it in 1973 in the Baton Rouge area In 1974, basically their first year of operation, they had sales of $248,000, but at the end of 1984 their sales were $29,495,000. The company paid taxes of $1,144,000. They paid salaries of $1,900,000. Assuming a 20-percent tax for the employees, it would have put another $392,000 in income tax back to the Government by its employees.

The second case was a company involved in industrial scaffolding. In 1971 we loaned them $180,000. Their income at the end of 1981—which is the last financial statement we have because they do not owe us any more money; they paid us back so they do not need to give us a statement—but the last one we had in 1981 their sales were $31 million. They paid $685,000 in taxes and $16 million in salaries. Again applying the 20-percent tax base would put another $3,220,000 in income tax by the employees.

The third case was an industrial warehouse company. We made them a loan of $215,000. At the end of 1983 their income was $3,474,000. They paid taxes of $182,000 and salaries of $1,485,000.

The fourth case is a situation where we financed a nursing home in a small rural area. We loaned them some money. They built a nursing home. In their fiscal year 1984 they had income of $1,128,000. They had taxes of $88,000, salaries of $549,000, which would have generated another $109,000 in income taxes.

The reason we needed SBA for these particular four applications was as follows:

In case No. 1 this was a new business being started by three brothers who had excellent experience but limited resources and could only provide inventory and chattels for collateral. As anybody who has ever made loans knows, if something happens and your collateral is inventory and chattels, there is not much to go after. It is a high-risk loan.

Case No. 2 involved, again, solid business people but the collateral was offered was scaffolding equipment, something that was very volatile and very movable. Again, we felt the risk was a little bit more than sound banking would have allowed us to take without some kind of guarantee.

The last two cases of the industrial warehouse and the nursing home, these people needed 20-year financing; they needed long-term financing. Again, we could not have done this without knowing we could get 90 percent of that money back if we had to do that.

We would have had to have turned these people down had we not had the use of the SBA guaranteed loan program.

An additional statistic that I want to just bring in here, because I have heard the SBA program attacked because of this, is that very few banks do participate in the guaranteed loan program. Although the number may be small, in our bank's case we service the entire State of Louisiana. You all indicated a much greater area than just your town.

The point is that, even though the number of banks participating may not be impressive as compared to total banks, I have no doubt that those banks participating are serving the whole country. You can serve a State very well. We deal with our correspondent banks that we have throughout our State. We are an independent bank but we work with them.

One of the reasons that more banks do not get involved is because, unless you do a volume, it is very difficult to be efficient at it. We offer as a sort of centralized place that we comake the loans with the smaller banks that may only have four or five cases a year where the need may have occurred.

In the case of the nursing home I mentioned, it was in a small town of some 3,000 population. They may not have more than two requests a year, but in that particular case we did it with them. We got them the loan. That employment for that small town from that nursing home is very, very vital to that town. They would never have gotten the money there any other way.

In conclusion, I would like again to restate that the four cases mentioned above, as well as many other deserving small business people, would not have had an opportunity to be productive owners of small business companies were it not for the availability of the SBA guaranteed loan program.

Our bank and many others like us would be seriously hampered in our ability to serve our small business customers without the availability of the SBA. Furthermore, we feel that the guaranteed loan program is a positive, income-producing entity for our Government. In 1 year, using the information I gave you a while ago, just the four companies I mentioned would have paid $6,118,000 in taxes. We have a lot of others who are also doing that, as the other witnesses mentioned a while ago. I know the same thing is true with them.

Even if you have losses, and even if the losses are greater than what was mentioned in your bank—referring to Mr. McCormick—which I think is an outstanding record, you can pay for a lot of losses, and if you have a loss, it is a one-time loss. This is an ongoing income that will go on and on and on.

I believe, again speaking of the facts, the facts will show that the SBA program is not an expense; it is an income for the Government. I think it puts much more money back in than it takes out.

Whereas the SBA guaranteed loan program is by no means a tool to make bad loans good, or to cure all the ills of small business, it has been a very positive and effective vehicle that has helped many small business firms start and maintain viable, healthy, tax-paying companies and provide a substantial number of jobs, which in all probability would not have been provided otherwise.

In business, if you are operating at a loss and you cannot balance your budget, you do not cut your income producer; you cut your losses. You never cut out what is making you a profit.

I contend that if it were looked at seriously the SBA is a profit center for the Government. I think to cut it out, in addition to hurting individual people's chances, would do harm to the budget rather than improve it.

The last thing I want to say is this: not only is it important to retain SBA, but I think it is critical that it be retained with a positive attitude. Even though it has not been killed over the past few years, it has been severely wounded by the attitude of whether it is going to be there or it is not going to be there.

I know in our district the bulk of the real quality people have quit SBA, have gone to work somewhere else, because of the uncertainty of their future.

I would ask you not only to help it to survive, but to give it its place as a viable agency, so that it will get good personnel and really make this thing work as well as it can.

Thank you very much.

[The prepared statement of Mr. Mitchell follows:]

STATEMENT BY: Arthur J. Mitchell,
Senior Vice President
Capital Bank & Trust Co.
1835 Wooddale Boulevard
Baton Rouge, Louisiana
on behalf of the Independent Bankers
Association of America

SENATE SMALL BUSINESS COMMITTEE
DATE OF TESTIMONY: February 21, 1985

I am here to offer testimony on behalf of the Independent Bankers Association of America, who represent 7800 banks nationwide, and also on behalf of Capital Bank & Trust Co. where I have been involved with the SBA Guaranteed Loan Program for the past fifteen years. I trust my testimony will be used as a basis for making a positive decision to retain the existance of the Small Business Administration and let it take its place among the other successful and viable government agencies that have served the American public well.

In the latter part of 1970, Capital Bank & Trust Co. was visited by the new Director and Chief Finance Officer of the Small Business Administration office in New Orleans, Louisiana. We were introduced to the SBA Guaranteed Loan Program and invited, as were other banks throughout the state, to make use of the program to help small business' and use it as a growth and profit vehicle for our bank.

At that time, Capital Bank & Trust Co. was a $74,000,000 bank and was in a city with four larger banks that posed formidable competition. We saw the SBA program as an excellent opportunity to assist small business customers and help our bank to grow. As we begin 1985, we have made 484 SBA guaranteed loans under the 7-A program totaling $77,692,780. Our assets at the end of 1984 are $540,000,000. Much credit for our growth and success is attributable to our use of the SBA Guaranteed Loan Program.

The primary reasons we have been so excited, and have consistently used the SBA program, is that we saw it as a means of filling a need for the small business man that was not being met and is still presenting problems in our current lending environment.

Due to a banks need to maintain liquidity in its assets, the making of long term small commercial loans was virtually impossible to do except in rare cases. Other sources of long term financing were equally unavailable due to the unwillingness to make "small commercial loans" by most of the life insurance companies and the unwillingness to make commercial loans by the other main source of long term financing, the Savings and Loan industry.

By having 90% of the loan to the small business man guaranteed by SBA, and with a consistant secondary market available to purchase the guaranteed portion, we have been able to provide long term fixed asset financing for our small business customers that we would not be able to do otherwise. We have also been able to make loans where credit was good but because of weakness in collateral, being a "start-up" business, or one with somewhat limited equity capital, we would not have been able to provide financing other than through the SBA Guaranteed Program.

An additional factor of great importance involving the SBA loan has been the amount of jobs that they have helped create. The 484 loans we have made have either created or sustained 6,559 jobs. Many of the SBA concerns have grown substantially and although there are no current statistics on employment, it is safe to say that the jobs created are substantially larger than 6,559.

It is unfortunate that, whereas, negative statistics have always been readily available concerning SBA regarding losses and business failures, there have been no statistics available to show its successes. I would like to give four brief profiles of businesses we were able to help start through the use of the SBA Guaranteed Loan Program.

Case #1:

We made a $90,000 guaranteed loan to a retail store in the Baton Rouge area in 1973. Their sales in 1974 were $248,740. Their sales at the end of 1984 were $29,495,480. They paid taxes of $1,144,439 and paid salaries of $1,962,223. Assuming a 20% average income tax base, this would be an additional $392,000 in income taxes paid by the employees.

Case #2:

This company is involved in industrial and commercial scaffolding rental operation. In 1971, we loaned them approximately $180,000. In 1981, the most current information we have available, sales were $31,244,253. They paid taxes of $684,767 and paid salaries of $16,100,000. Again, assuming a 20% tax base for employees, an additional payment of $3,220,000 would be paid in income taxes for 1981.

Case #3:

This company is involved in industrial warehouse and transport. In 1971, we made them an SBA loan of $215,000 to go into business. As of December, 1983, they had income of $3,474,470 and paid taxes of $182,022 and paid salaries of $1,485,659. These wages would have resulted in approximately $297,000 being paid in income taxes.

Case #4:

This customer requested and was granted a loan in approximately 1977 to construct a nursing home in a small town approximately 65 miles from Baton Rouge. For their year-end, 1984, they had an income of $1,128,778 and paid taxes of $88,817 and paid salaries of $549,465 which generated $109,000 in income taxes. This nursing home is in a small town with approximately 3,000 population and has become a significant employment source for this small rural town.

The reason we needed SBA for these particular four applicants were as follows:

Case #1 was a new business being started by three brothers who had excellent experience but limited resources and could only provide inventory and chattels for collateral. Case #2 involved solid business people but the collateral offered was portable scaffolding equipment, which we felt was a risk beyond what normal banking policy allowed us to take. Case #3 and #4, because they involved long term real estate financing, we were unable to finance them due to inability to make long term loans of this type and maintain adequate liquidity within our bank. Again, through the guaranteed loan program, we were able to sell in the secondary market 90% of these loans and provide our customers with financing while maintaining adequate liquidity.

An additional statistic concerning the guaranteed loan program that we feel is misleading is the fact that a relatively few number of banks have actively participated in the SBA Guaranteed Loan Program. In our case, we have provided this service for any deserving customer within the state of Louisiana. We feel that this is not an unusual situation and that although the number of banks that participate may not seem large, I have no doubt that these banks are adequately serving the needs of all small business SBA loan requests throughout the United States.

In conclusion, I would like to again restate that the four cases mentioned above, as well as many other deserving small business people, would not have had an opportunity to be productive owners of small business companies were it not for the availability of the SBA Guaranteed Loan Program. Our bank and many others like us would be seriously hampered in our ability to serve our small business customers without the availability of the SBA Guaranteed Loan Program; furthermore, we feel that the SBA Guaranteed Loan Program is a positive, income-producing entity for our government. I believe taxes paid by the numerous, successful companies, such as the four mentioned previously and their employees, would more than offset any losses incurred in those loans made where the small business man was unable to succeed.

Whereas, the SBA Guaranteed Loan Program is by no means a tool to make bad loans good, or to cure all ills of small business, it has been a very positive and effective vehicle that has helped many small business firms start and maintain viable, healthy, tax paying companies and provided a substantial number of jobs which in all probability would not have been provided otherwise.

The **Chairman**. Thank you for your comments.

The last point you raised—and I do not want to take in any way advantage of the absence of Mr. Stockman—but this is obviously a point that I am going to go into with him. Let me say this:

His rhetoric on this matter of eliminating SBA has absolutely devastated the personnel in that agency. Indeed, if you worked for SBA right now, chances are you would be out looking for a job before the ax falls. I want to point out the disservice that has been performed in that sense.

Now to the extent that my voice is listened to, and that of Senator Bumpers, I can only assure the personnel at SBA that I can give an educated guess—an educated guess, not a wish guess but an educated guess—as to what is going to come out of all of this. I can assure you that I expect the passage of this 3-year authorization for SBA and not the elimination of the agency.

Mr. **Mitchell**. Thank you.

The **Chairman**. The next witness is Mr. Bailey Barnard, who is the chairman of the board and chief executive officer of First Capital California Business and Industrial Development Corp. of San Francisco.

Welcome, Mr. Barnard.

STATEMENT OF BAILEY S. BARNARD, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, FIRST CAPITAL CALIFORNIA BUSINESS AND INDUSTRIAL DEVELOPMENT CORP., SAN FRANCISCO, CA

Mr. **Barnard**. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, my name is Biff Barnard. I am the president of the National Association of Government Guaranteed Lenders, acronym NAGGL, as well as chairman and chief executive officer of First Capital California Business & Industrial Development Corp. in San Francisco.

I would just like to comment, I hope you like the California weather I brought with me for the past couple days. [Laughter.]

As you may know, the only business of Calbidco is making loans using SBA guarantees.

First, I would like to commend the chairman and Senator Bumpers for their leadership role in focusing the attention on the need to retain to SBA and its effective programs. I am pleased to have the opportunity to work with you on these important issues.

I have also submitted written testimony that I would like to have made part of the record.

NAGGL, the National Association of Government Guaranteed Lenders, is an organization of lenders, brokers, and investors that actively participate in the loan guarantee programs of the SBA. NAGGL represents both large and small lenders who collectively are responsible for a large part of the SBA loan guarantee activity done nationally.

NAGGL adamantly opposes the Reagan administration's budget proposal to eliminate the SBA and strongly supports the guaranteed loan program for small business as a partnership between the public and private sectors, using the private sector capital to create jobs and stimulate the economy.

The Small Business Administration must maintain its status as an autonomous agency. The mandate of the SBA has broadened over its 30-year history as Congress has continually added new programs to the agency's responsibilities. While each of these programs must be judged on its own merits, NAGGL believes that the criticisms of the SBA loan guarantee programs are uninformed, inaccurate, and unjustified considering its importance as a source of long-term capital for small business.

Budget Director Stockman demonstrates his naivete and lack of understanding of the financial marketplace in his contention that the Federal loan guarantees are unnecessary, that private capital sources alone are sufficient for expansion financing for business. There is, in reality, a void in the financial marketplace. Without the guarantees of the SBA, long-term capital is simply not available to many good quality, credit-worthy small businesses.

Our loan portfolios, the groups of people here which are outlined I think in greater detail in our written testimony, demonstrate the contribution that lenders and the SBA are making to small business and the importance of the availability of long-term loans to these small businesses.

My company has been in business for 2 years. We have made 46 loans totaling about $12 million. The jobs have increased of our portfolio companies from 543 to 1,090. It is an increase of 422 or 78 percent in a 2-year period.

Only one of our loans has repurchased by the SBA. It was a $135,000 loan, which represents a loan loss of just about 1 percent without taking into consideration any collateral that might be collected upon.

We sell all of our loans on the secondary market. Because we are a nondepository institution, we are totally dependent upon the maximum SBA guarantee and the secondary market. We must sell our loans in order to make additional loans.

We heard of large success stories in earlier testimony. Our borrowers all demonstrate their own small success stories. I would like to give you one example of one of our borrowers which is a 2-year-old San Jose, CA, manufacturer of switching power supplies that are used in microcomputers and communications equipment. This is not high tech; this is low tech.

The company's bank was able to provide short-term debt but was not willing to provide the long-term debt necessary for the company to expand and referred the company to First Capital. With the use of a 90-percent guarantee, we were able to provide the company with an 8-year, fully amortized loan of $350,000. As a result of its expanded facilities and upgraded equipment, the company increased its sales from $2 million to $3.2 million in 1 year. It increased its employment from 70 people to 90 people. It increased its production efficiency through the new equipment and enabled increased profits. The company is projecting $7 million in volume this year and anticipates hiring more employees.

Mr. Chairman, the point is that the partnership of lenders and the SBA is making a difference. We are providing long-term financing to good quality, credit-worthy companies, financing that is simply not available conventionally. Without the guarantees of the SBA, thousands of small businesses would go without the financing necessary to enable them to expand, create new jobs, and generate more tax revenue to the Federal Government.

In attempting to measure the impact of the SBA loan program upon small business, it is important to point out that the major purpose of SBA guaranteed loans is to give small businesses access to long-term financing.

There are several other factors that we think the committee should consider in evaluating the SBA loan program. The administration points to misleading statistics in its contention that default rates on loan guarantee programs are unacceptably high, and this points to Senator Kasten's point.

Many of the loans that go into default—that means they are delinquent for 60 days or more—and are purchased by the SBA from lenders are turned around, are made viable, and are eventually paid off by the borrowers. Other loans may end up being liberated but the SBA collects all it can on the property that is pledged as collateral. The SBA's actual loss rate as opposed to default rate on the 7(a) loan guarantee program through the end of 1983 was less than 5 percent, not the figures that are quoted by the administration.

It has been estimated that for every $1 billion of SBA guaranteed loans approximately 100,000 jobs are created or retained in the private sector. As a result, the Government realizes a significant return on its investment through increased business and personal taxes as well as its savings on welfare compensation payments. In fact—and this goes along with what these gentlemen have said—it has been estimated that each dollar of SBA financing actually generates $7 of revenue to local and Federal governments. In effect, the loan guarantee program stimulates the economy, returns money to the Government after covering the cost of administration and losses.

Some have proposed that the Loan Guarantee Program be reduced from the present 90 percent to 75 percent. If this occurs, most of the nonbank lenders and the smaller bank lenders would no longer be able to afford to participate in the program, considering reducing the access of long-term capital to small businesses.

The simple facts are that, with $1 million of lender capital and 90 percent SBA guarantee, $10 million of loan funds are available. However, with that same $1 million and a 75-percent guarantee, only $4 million is available. It is a decrease of 60 percent. Under such circumstances, many lenders presently very active in the program would be forced out, and even fewer small businesses would be helped.

In summary, it is clear that the SBA's Loan Guarantee Program does fill a void in the financial marketplace and, properly administered, results in a positive impact on the economy and generates revenue in excess of cost for the Federal Government, and is the perfect partnership of the private sector and public sector working together to create jobs.

On behalf of lenders active in the Loan Guarantee Program of the SBA throughout the country, the National Association of Government Guaranteed Lenders adamantly supports the retention of the SBA as an independent agency and the retention of the SBA Loan Guarantee Program as outlined in your proposed legislation,

S. 408. We look forward to working with you as this legislation moves ahead.

Thank you.

[The prepared statement of Mr. Barnard follows:]

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Statewide CALBIDCO

John C. Wagner
The Money Store

ORAL STATEMENT
OF
BAILEY S. BARNARD

ON BEHALF OF
THE NATIONAL ASSOCIATION OF
GOVERNMENT GUARANTEED
LENDERS

BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

FEBRUARY 21, 1985

One Powell Street, 6th Floor, San Francisco, California 94102
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Mr. Chairman and members of the Committee, my name is Biff Barnard. I am the President of the National Association of Government Guaranteed Lenders (NAGGL) and Chairman of the Board and Chief Executive Officer of First Capital California Business and Industrial Development Corporation (First Capital CALBIDCO) located in San Francisco.

I commend the Chairman for his leadership role in focusing attention on the need to retain the SBA and its effective programs. I am pleased to have the opportunity to work with you on these important issues.

The National Association of Government Guaranteed Lenders is an organization of lenders, brokers, and investors that actively participate in the loan guarantee program of the Small Business Administration. The Association represents both large and small lenders who collectively are responsible for a large part of SBA guaranteed lending activity done nationally.

The Association adamantly opposes the Reagan Administration's budget proposal to eliminate the Small Business Administration and strongly supports the government guaranteed loan program for small business as a partnership between the public and private sectors using private sector capital to create jobs and stimulate the economy.

It is the position of the Association that the Small Business Administration MUST maintain its status as an autonomous agency. The mandate of the SBA has broadened over its 30-year history as Congress has continually added new programs to the Agency's responsibilities. While each of these programs must be judged on its own merits, the Association believes the criticisms of the SBA loan guarantee program are uninformed, inaccurate and unjustified considering their importance as a source of long term capital for small business.

Mr. Stockman demonstrates his naivete and lack of understanding of the financial marketplace in his contention that federal loan guarantees are unnecessary, that private capital sources alone are sufficient for expansion financing for business. There is, in reality, a void in the financial marketplace. Without guarantees by the SBA, long term capital is simply not available to many good quality, creditworthy small businesses.

First Capital CALBIDCO is a good example of the non-bank membership component of the Association and our portfolio of borrowers demonstrates the contribution lenders and the SBA are making to small businesses and the importance of the availability of long term loans to these small businesses. The only business of CALBIDCO's is making long term loans using guarantees by the SBA. First Capital is privately capitalized and has 35 stockholders - primarily individuals.

First Capital has been operating for slightly more than two years. We have made 46 loans to start-up or expanding businesses in California totalling approximately $12,650,000 ($11,385,000 guaranteed by the SBA/ $1,265,000 of our own capital at risk.) We made 10 loans our first year, 30 our second year and by the end of calendar year 1985 we anticipate having a portfolio of in excess of 100 loans totalling almost $30,000,000 and having created about 1,000 new jobs. Through our loans the number of jobs produced by these companies has increased from 543 to 1090; an increase of 424 or 78% which represents 1 new job per each $29,838 lent.

Only one of our loans has been repurchased by the SBA. It was a $135,000 loan which represents a maximum loan loss of just in excess of 1% without taking into consideration any collections from foreclosure on the collateral.

We sell all of our loans to secondary market investors. Because we are a non-depository institution, we are totally dependent upon the maximum SBA guarantee and the secondary market. We must sell our loans in order to make additional loans.

A representative borrower of First Capital is a San Jose, California, manufacturer of switching power supplies that are used in microcomputers and in communications equipment. Using the company's own capital and short term debt, in a two-year period the company was able to grow to $2 million in sales employing 70 people. In order to continue to expand to meet demand for its product, it needed long term capital to purchase new equipment and increase the size of its facility. The company's bank was able to continue providing short term debt, but was not willing to provide the long term debt and referred the company to First Capital. With the use of a 90% SBA guarantee, we were able to provide the company with an 8-year fully amortized loan of $350,000.

As a result of its expanded facilities and upgraded equipment, the Company:

1. Increased its sales from $2 million to $3.2 million by the end of 1984;

2. Increased its employment from 70 to 90;

3. Increased its production efficiency through the new equipment enabling increased profits; and

4. Is projecting a sales volume of $7 million in 1985 and anticipates hiring additional employees.

The point is that lenders using the SBA loan guarantee program are making a difference. They are providing long term financing to good quality, creditworthy companies - financing that is simply not available conventionally. Without the guarantees by SBA, thousands of small businesses would go without the financing necessary to enable them to expand, create new jobs, and generate more tax revenue to the federal government.

In attempting to measure the impact of the SBA loan program upon small business it is important to point out that the major purpose of SBA guaranteed loans is to give small businesses access to long term financing. It is the SBA loan guarantee program that has made possible what long term financing does exist for small businesses. In its April 1983 study the GAO estimates that "approximately 30 to 40 percent of the dollar amount of banks' long term financing (6 or more years) to small businesses may carry an SBA guarantee."

There are several other factors that are important for the Committee to consider in evaluating the SBA loan guarantee program:

The Administration points to misleading statistics in its contention that default rates of the loan guarantee program are unacceptably high. Many of the loans that go into "default" (delinquent for 60 days or more) and are purchased by the SBA from lenders are turned around, made viable and are eventually paid off by the borrower. Other loans may end up being liquidated, but the SBA collects all it can from the property pledged as collateral for the loan. SBA's actual loss rate (net losses divided by loan disbursements) on 7(a) guaranteed loans through the end of fiscal 1983 was less than 5%.

It has been estimated that for every $1 billion of SBA guaranteed loans, approximately 100,000 jobs are created or retained in the private sector. As a result, the government realizes a significant return on its investment through increased business and personal taxes as well as its savings on welfare compensation payments. In fact, it has been estimated that each dollar of SBA financing generates $7 of revenue to local and federal governments. In effect, the SBA loan guarantee program returns money to the government after covering the cost of administration and losses!

Some have proposed that the guarantee be reduced from the present 90% to 75%. If this occurs, most non-bank lenders and many smaller banks would no longer be able to afford to participate in the program - considerably reducing the access to long term capital by small businesses. The simple but dynamic facts are that with $1 million of lender capital and a 90% SBA guarantee, $10,000,000 of loan funds are available. However, with that same $1 million and a 75% guarantee only $4,000,000 is available - a decrease of 60%! Under such circumstances, entities such as First Capital CALBIDCO would cease to exist.

In summary, it is clear that SBA's loan guarantee program does fill a void in the financial marketplace and properly administered results in a positive impact on the economy, generates revenue in excess of costs for the federal government and is the perfect partnership of the private sector and public sector working together to create jobs.

On behalf of lenders active in the loan guarantee program of the SBA throughout the country, the National Association of Government Guaranteed Lenders adamantly supports the retention of the SBA as an independent agency and the retention of the SBA loan guarantee program as outlined in your proposed legislation S. 408.

We look forward to working with you, Mr. Chairman, as this legislation moves forward.

Thank you.

National Association of Government Guaranteed Lenders, Inc.

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First Interstate Bank
of California

John Neiswender
Statewide CALBIDCO

John C. Wagner
The Money Store

STATEMENT

OF

BAILEY S. BARNARD

PRESIDENT

NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS

AND

CHAIRMAN OF THE BOARD/CHIEF EXECUTIVE OFFICER
FIRST CAPITAL CALIFORNIA BUSINESS AND INDUSTRIAL
DEVELOPMENT CORPORATION

BEFORE THE U.S. SENATE COMMITTEE ON SMALL BUSINESS

FEBRUARY 21, 1985

One Powell Street, 6th Floor, San Francisco, California 94102
6350 Laurel Canyon Blvd., North Hollywood, California 91606-3274

Mr. Chairman and members of the Committee, I appreciate the opportunity to speak in strong support of retaining of the Small Business Administration and its business loan guarantee programs.

My name is Biff Barnard. I am President of the National Association of Government Guaranteed Lenders (NAGGL) and Chairman of the Board and Chief Executive Officer of First Capital California Business and Industrial Development Corporation (First Capital CALBIDCO) located in San Francisco.

NAGGL is an organization of lenders, brokers, and investors that actively participates in the loan guarantee program of the Small Business Administration. The Association represents both large and small lenders who collectively are responsible for a large part of SBA guaranteed lending activity done nationally.

The National Association of Government Guaranteed Lenders adamantly opposes the Reagan Administration's Budget Proposal to eliminate the Small Business Administration. It is the position of the Association that the Administration proposal is counterproductive to achieving the goals of reducing the budget deficit while stimulating economic growth. The Association strongly supports government guaranteed loan programs for small business as a partnership between the public and private sectors using private sector capital to create jobs and stimulate the economy.

The Association was formed for the purposes of building greater awareness among decision makers in both the public and private sectors of the true benefits of government guaranteed loan programs and their contribution to job creation and economic growth and assisting the Small Business Administration in making its loan guarantee program more cost effective and more available to America's small businesses.

RETAIN THE SBA

It is the position of the National Association of Government Guaranteed Lenders that the Small Business Administration MUST maintain its status as an autonomous agency whose mission should be to advocate for and assist America's small businesses in a partnership with the private sector. Recognizing the importance of small business as a source of job creation and economic growth, Congress created the Agency to provide a source of long term capital for this vital sector of our national economy.

RETAIN THE LOAN GUARANTEE PROGRAM

The mandate of the SBA has broadened over its 30 year history as Congress has continually added new programs to the Agency's responsibilities. While each of these programs must be judged on its own merits, NAGGL believes the criticisms of the SBA loan guarantee program are uninformed, inaccurate and unjustified considering their importance as a source of long term capital for small business.

LACK OF AVAILABILITY OF TERM FINANCING

Mr. Stockman demonstrates his naivete and lack of understanding of the financial marketplace in his contention that federal loan guarantees are unnecessary, that private capital sources alone are sufficient for expansion financing for business. The Administration contends that the SBA credit programs duplicate assistance provided more effectively by the private sector. There is, in fact, a void in the financial marketplace. Without guarantees of the SBA, term capital is simply not available to many good quality, creditworthy small businesses.

First Capital CALBIDCO is a good example of the non-bank membership component of NAGGL and our portfolio of borrowers demonstrates the contribution lenders and the SBA are making to small businesses and the importance of the availability of long term loans to these small businesses.

First Capital is one of 10 BIDCO's in California. CALBIDCO's were created by the California State Legislature in the late 1970's to be licensed by the California Banking Department to enable them to participate in the SBA loan guarantee program. The only business of CALBIDCO'S is making long term loans using guarantees of the SBA. First Capital is privately capitalized and has 35 stockholders - primarily individuals.

First Capital has been operating for slightly more than two years. We have made 46 loans to start-up or expanding businesses in California totalling approximately $12,650,000 ($11,385,000 guaranteed by the SBA/$1,265,000 of our own capital at risk). We made 10 loans our first year, 30 our second year and by the end of calendar year 1985 we anticipate having a portfolio of in excess of 100 loans totalling almost $30,000,000 and having created about 1,000 new jobs. Through our loans the number of jobs produced by these companies has increased from 543 to 1090 an increase of 424 or 78% which represents 1 new job per each $29,838 lent.

Our portfolio companies represent a variety of INDUSTRIES:

Service	46%
Retail	14%
Wholesale	14%
Manufacturing	27%

The companies have been at various STAGES OF DEVELOPMENT at the time of funding:

Start-up	35%
1 - 3 years	3%
4 - 6 years	16%
7 - 10 years	16%
more than 10 years	27%

The TERMS of our loans are all in excess of five years:

5 - 7 years	48%
8 - 14 years	19%
15 - 25 years	33%

Only one loan has been repurchased by the SBA. It was a $135,000 loan which represents a maximum loan loss of just in excess of 1% without taking into consideration any proceeds of foreclosure on the collateral.

We participate in the SBA's Certified Lender's Program (CLP). Under this program processing time for applications submitted to SBA is significantly reduced for lenders who are experienced in the loan guarantee program. The purpose of the CLP is to put more burden on the experienced lender and reduce the SBA's administrative expense. Only one loan that we have submitted has been rejected by the SBA.

We sell all of our loans to secondary market investors. Because we are non-depository, we are totally dependent upon the maximum SBA guarantee and the secondary market. We must sell our loans in order to make additional loans.

By reducing the guarantee from the present 90% to 75%, as has been proposed by some, most non-bank lenders and many smaller banks would no longer be able to afford to participate in the program - considerably reducing the term capital available to deserving small businesses.

The simple but dynamic facts are that with $1 million of lender capital and a 90% SBA guarantee, $10,000,000 of loan funds are available. However, with that same $1 million and a 75% guarantee only $4,000,000 is available - a decrease of 60%!

Under such circumstances, entities such as First Capital CALBIDCO would cease to exist.

A representative borrower is a San Jose, California manufacturer of switching power supplies that are used in microcomputers and in communications equipment.

Having been in production for two years the company had reached $2 million in sales and had 70 full-time employees. By the end of 1983, however, the company had reached its limit in sales growth that could be financed on a short term basis with its bank. Long term capital was required to expand its facility and purchase additional production equipment.

The company's bank was willing to expand its short term line of credit but was not willing to provide any term debt. The company's principals had put all their capital into the company at the beginning and venture capitalists were not interested.

The company's bank referred them to First Capital. With the use of a 90% SBA guarantee, we were able to provide the company with an 8 year fully amortized loan of $350,000.

As a result of its expanded facilities and upgraded equipment, the company:

1. Increased its sales form $2 million to $3.2 million by the end of 1984;
2. Increased its employment from 70 to 90;

3. Increased its production efficiency through the new equipment, enabling increased profits; and

4. Is projecting a sales volume of $7 million in 1985 and anticipates hiring additional employees.

The point is that our emphasis is on good quality, expanding companies which do not have the perceived growth potential to attract venture capital, as they are companies who will probably never go public, but whose financing needs are of a longer term nature than can be obtained conventionally. Without the guarantees by the SBA thousands of small businesses would go without the financing necessary to enable them to expand and therefore, create new jobs and generate more tax revenues to the Federal Government.

Letters from a number of small businesses supporting the SBA and the loan guarantee program are attached for the record.

In attempting to measure the impact of the SBA loan program upon small business it is important to point out that the major purpose of SBA guaranteed loans is to give small businesses access to long term financing. This subject was explored by the U.S. General Accounting Office (GAO) in its study of the 7(a) program dated April 1983.

> Small businesses require long term debt financing for a variety of reasons including plant expansion and acquisition and equipment purchases. However, they have had

problems obtaining such financing as far back as 50 years ago and the problems that small businesses faced then are the same today.

The GAO report describes studies and hearings published between 1935 and 1982 by the U.S. Department of Commerce, the Federal Reserve Board, the Senate Banking Committee, the Committee for Economic Development, and the Federal Interagency Task Force on Small Business Finançe, each of which came to the same conclusion: that a serious credit gap exists in which many small businesses are unable to meet their needs for long term credit.

It is the SBA loan programs that have made possible what long term financing does exist for small businesses. The GAO estimates that "approximately 30 to 40 percent of the dollar amount of banks' long term financing (6 or more years) to small businesses may carry an SBA guarantee."

LOSS RATE LESS THAN 5%

The Administration points to misleading statistics in its contention that loan default rates of the SBA loan guarantee program are unacceptably high. Many of the loans that go into "default" (delinquent for 60 days or more) and are purchased by the SBA from lenders can be turned around, made viable and are eventually paid off by the borrower. Other loans may end up being liquidated but the SBA collects all it can from the property pledged as collateral of the loan. SBA's actual loss rate (net losses divided by loan disbursements) on 7(a) guaranteed loans through the end of fiscal 1983 was 4.95%!

EMPHASIS ON BETTER QUALITY BORROWERS

Particularly under SBA Administrator James Sanders and under the close supervision of this Committee, "quality loans" have been the focus of both the SBA and lenders who participate in the guaranteed loan program. Both the SBA and lenders are looking for a combination of management capability, financial condition, cash flow and collateral of an applicant. As a result the default and delinquency rate of SBA loans made during the past 3 years continues to improve.

The Small Business Act requires that 7(a) loans must be "of such sound value or so secured as reasonably to assure repayment". A 7(a) loan, therefore, is for a business that can demonstrate its ability to service and repay the loan but is unable to obtain a loan conventionally that meets the term nature of its financing needs.

IMPACT ON DEFICIT AND INTEREST RATES

Because the federal budget deficit is a serious problem which must be addressed, the impact of the SBA's loan guarantee program on it and interest rates in general must be considered. The benefits derived from these programs need to be considered to determine whether the costs to support them are justified. In 1977, SBA conducted a study of its 7(a) loan guarantee program to determine its actual costs and benefits. The conclusions of that study, in summary, were that $1 billion of SBA guarantee loans have the potential to create and maintain 100,000 jobs in the private sector. As a result, the government would realize a significant return on its investment through increase in business and personal taxes as well as its savings on welfare compensation payments. In fact, it has been estimated that each dollar of SBA financing generates $7 of revenue to local and federal governments. In effect, the program returns money to the government after covering the cost of administration and loan losses. The conclusion to be drawn is that the public and private sectors can work constructively together to each other's benefit through creatively designed programs such as the SBA's loan guarantee program.

IMPACT ON CAPITAL MARKETS

Another often heard argument from Administration critics is that the program impact the capital markets by causing an increase in interest rates thereby crowding out other small business borrowers. In considering this possibility, the April 1983 GAO study reported that 95% of the surveyed lenders said that the 7(a) program had little or no effect on credit extention to other small business borrowers. The study concluded that, "because the (SBA) Loan Guarantee Program is such a small part of overall federal and private sector credit assistance, its impact on interest rates and capital flows cannot be precisely isolated". In other words, the extent to which federal borrowing to fund these programs impacts interest rates is so inconsequential that it cannot be measured.

As active commercial lenders, we are very aware of the productivity and job creation potential of small business. To eliminate the SBA and its business loan guarantee program would create a shortage of capital necessary to finance the growth of what is recognized as the most productive sector of our economy and would be counterproductive to achieving the economic goals of the Reagan Administration.

It is clear that SBA's loan guarantee program does fill a void in the financial marketplace and properly administered results in a positive impact on the economy, generating revenue in excess of costs for the federal government. It is a perfect partnership of the private and the public sector working together to create jobs.

On behalf of lenders active in the loan guarantee program of SBA throughout the country, the National Association of Government Guaranteed Lenders adamantly supports the retention of the Small Business Administration as an independent agency and its business loan guarantee program as outlined in your proposed legislation, S. 408.

Thank you.

Honorable Lowell E. Weicker
Chairman, Senate Small Business Committee
Washington, DC

14 FEB 85

Dear Mr. Weicker,

I am in opposition to the elimination or curtailment of the Small Business Administration as has been proposed by President Reagan in his effort to reduce the Federal Budget deficit.

I own and have operated for approximately a year a retail microcomputer software store originally financed by the SBA. We are a service oriented software store that carries mainly business and educational software which we sell to corporations, independent businesses and individuals in the silicon valley of California. My business has grown from sales of $5000 to $100,000 per month within the first twelve months of operation.

The hard costs for starting a business of this kind is a minimum of $200,000. Not being independently wealthy nor in near term expectation of becomming heir to a large fortune, I sought long term financing of funds to establish my business. I prepared a comprehensive five year business plan which I presented to no fewer than 10 banks/loan institutions. The response was always "no" mainly for the following reasons:

* My industry was not understood or deemed too unstable
* I had a high debt to equity ratio
* I had no previous business experience

I was unable to obtain financing through traditional lending institutions because of the Federal lending regulations they are placed under in addition to the conservative orientation of most bank officials.

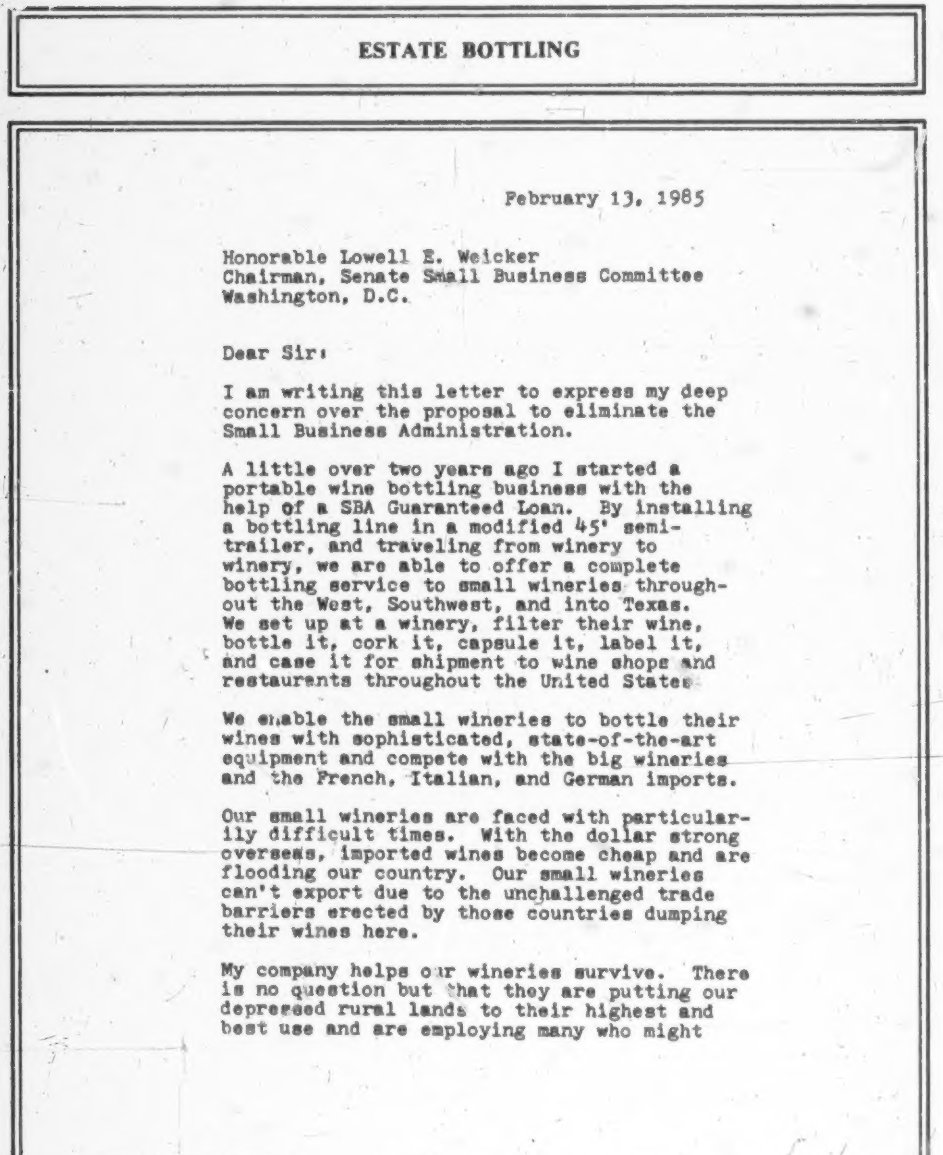
I subsequently obtained SBA guaranteed financing through the much appreciated efforts and confidence of First Capital Corporation of San Francisco. The funds provided to me through the SBA have had the following results:

* I am making a positive contribution to the economy of Silicon Valley.
* I am generating sales tax revenue
* I am employing four people productively in a necessary industry
* I am repaying my SBA loan

Without SBA financing, I do not feel I would have been allowed to develop or experience the success of my own personal business. I will support any efforts necessary to allow other qualified individuals to share in one of the fundamental dreams of our Democratic society.

Sincerely,

Frank G. Robinson dba Software Galeria of San Jose



ESTATE BOTTLING

February 13, 1985

Honorable Lowell E. Weicker
Chairman, Senate Small Business Committee
Washington, D.C.

Dear Sir:

I am writing this letter to express my deep concern over the proposal to eliminate the Small Business Administration.

A little over two years ago I started a portable wine bottling business with the help of a SBA Guaranteed Loan. By installing a bottling line in a modified 45' semi-trailer, and traveling from winery to winery, we are able to offer a complete bottling service to small wineries throughout the West, Southwest, and into Texas. We set up at a winery, filter their wine, bottle it, cork it, capsule it, label it, and case it for shipment to wine shops and restaurents throughout the United States.

We enable the small wineries to bottle their wines with sophisticated, state-of-the-art equipment and compete with the big wineries and the French, Italian, and German imports.

Our small wineries are faced with particularily difficult times. With the dollar strong overseas, imported wines become cheap and are flooding our country. Our small wineries can't export due to the unchallenged trade barriers erected by those countries dumping their wines here.

My company helps our wineries survive. There is no question but that they are putting our depressed rural lands to their highest and best use and are employing many who might

PORTABLE WINE BOTTLING P.O. BOX 1743, PLEASANTON, CALIFORNIA 94566 / (415) 484-3062

otherwise not have jobs in these remote areas. I am proud to have a small part in preserving this and our agrarian way of life. It has taken a lot of my hard work, a foresighted and supportive lender, and a SBA Guaranteed Loan.

I am 44 and have been in the wine business all my life. I saw the need for this type of service after my family's own winery, founded by an Italian immigrant, went out of business when the prime rate went over 20%. After researching the concept of portable bottling and developing a comprehensive business plan, I was unable to borrow the capital necessary to start this business after making sound, professional presentations to over 40 banks, leasing companies, and venture capital firms. I finally secured financing through First Capital California Business and Industrial Development Corporation with a SBA Guaranteed Loan.

Because of this, I am employing people, paying taxes, collecting taxes for the Government, and contributing to the productivity, employment, wonderful wines, and way of life our great industry offers.

I hope your committee will overwhelmingly recommend continuance of the SBA and the fine services it offers to all, particularily those who have had fewer advantages in terms of practical experience and education than I.

Very truly yours,

W. M. Harrison, Jr.
Owner/Operator

cc: Honorable Alan Cranston
Honorable Pete Wilson
Honorable Fortney Stark

DM CUSTOM FURNITURE INC.
925 Hensley St.,Richmond,Ca.94801,415/232-1696

February 13, 1985

Honorable Lowell E. Weicker
Chairman, Small Business Committee
Washington, D.C.

Dear Senator Weicker:

I would like to take a moment of your time to express my dismay at the possible elimination of the SBA.

My company manufactures high quality wood office furniture. We are involved in all processes from rough lumber through the finishing process.

A few years ago, we had grown from a small custom shop to a medium-sized standard goods manufacturer. We suddenly found ourselves competing with much larger companies who have more sophisticated equipment, and, therefore, better pricing than ours. We needed to improve some of our equipment and working environment so we could produce a better product in less time.

We tried to get long-term financing from our bank. They did not offer this type of financing. Other lending institutions would not consider us because we had no track record with borrowing and repaying a large debt.

We were referred to First Capital by our bank, and, with the guarantee of the SBA, we were able to obtain our loan.

With this loan, we were able to greatly improve our finishing department by improving quality, increasing output, and improving the working environment. On the woodworking side of the plant, we acquired several pieces of timesaving equipment and a dust collection system.

At the sales end, some of the money was used toward a new catalog which will soon be out. With some of the temporary literature that is already out, we see this catalog improving our business greatly.

We are very grateful for the help of the SBA and feel that this loan was a big step in helping us to compete and continue to grow. I hope other companies will also get the same opportunity.

Please do not abolish the SBA.

Sincerely,
DM Custom Furniture, Inc.

Tom O'Connor

Tom O'Connor
Vice President

TO/kdm

Applied LASER Systems
3330 victor court • santa clara, ca 95054 • (408) 727-4190

February 12, 1985

Honorable Lowell E. Weiker
Chairman, Senate Small Business Committee
Washington, DC

Dear Senator Weiker:

It is with great concern that we have learned of the proposal to eliminate the Small Business Administration as part of the effort to reduce the Federal Budget deficit.

For the past eight years, we have been in the business of providing laser machining and processing services to a large number of companies covering a broad spectrum of industries. Our equipment is very expensive, and we have had to use a number of piecemeal methods to acquire it - mostly through special assistance from the manufacturers who wanted to be able to show it off in our facility. These arrangements are now much more difficult to negotiate.

As our industry, which encompasses materials processing with laser equipment, has grown, we have had to pursue a more orderly growth which requires that we systematically pursue opportunities as they develop. This requires capital for the purchase of expensive laser systems as well as working capital.

We began our search for financing through conventional sources in May of 1984, and were unable to obtain long-term financing until First Capital assisted us in securing an SBA Guaranteed Loan in January of 1985. This loan has given us the working capital to significantly expand our sales and marketing as well as purchase the capital equipment required to manufacture those products which the expanded sales and marketing effort have produced.

Again, we would like to reiterate our support for the Small Business Administration and its Guaranteed Loan Program as well as the benefits which derive from a healthy and growing business such as new jobs, higher tax revenues, etc.

Sincerely yours,

Frank Foster

Frank Foster
President

FF/

OVERLAY
INCORPORATED
[illegible] POWER INN ROAD · SACRAMENTO, CALIFORNIA [illegible] [illegible]

February 15, 1985

Honorable Lowell E. Weicker
Chairman, Senate Small Business Committe
Washington D.C.

Dear Sir:

I am writing this letter in support of the Small Business Administration Guarantee Program.

Overlay, Incorporated has been in business for approximately one year, and manufactures hardwood plywood in the Sacramento area, employing 23 people.

Overlay was a start up business, and would not be existance without the benefit of S.B.A. programs.

Sincerely,

Verne A. Stark, Jr.
General Manager

VAS: ac

California Capital
A California Business and Industrial Development Corporation

February 12, 1985

As a senior financial executive and the Head of Lending and Loan Service for the major operating subsidiary of a San Francisco headquartered private investment bank, I am writing you to speak out strongly and clearly against the proposal contained in the Administration's Fiscal Year 1986 Budget to eliminate the U.S. Small Business Administration ("SBA"). For 14 years, I have devoted my career to assiting hundreds of smaller businesses to realize the uniquely American dream of independence, entrepreneurship, economic growth, and community contribution. I urge you to review the accomplishments of the Agency and understand the importance of its functions.

The SBA is an independent U.S. Government agency created by Congress in 1953 to encourage, assist, and protect the interests of American small businesses. Since 1953, the SBA has been the only Nationwide source small-business owners and would be owners could rely on for financial, management and advocacy assistance. In its thirty year history, the SBA has undergone numerous changes, many of them philosophical as Presidential administrations changed, but none as important or far-reaching as the changes of three years ago.

Under the direction of the SBA Administrator. James C. Sanders, and the U.S. Senate Committee on Small Business headed by Chairman Lowell Weicker, many positive developments have been made at the SBA.

Loan defaults are down over 50% from 1982. Quality loans are a rule, not the exception. A report from GAO estimates that nearly 40 percent of the nation's small business long-term business financing is backed by SBA loan guarantees, a clear indication that quality small firms continue to be locked out of the traditional long-term credit markets.

There has been an emphasis on the private banking sector to absorb more of the responsibility in the loan process under the Preferred Lender Program. There have been major improvements in the Secondary Market under the newly approved Secondary Market Improvement Act which will streamline the sales of the guaranteed portion of SBA loans, thus adding to the efficiency of the process and providing additional access to capital for small growing companies.

Clearly, small business needs a mechanism like the SBA guaranteed loan program to assure it access to bank borrowing.

100 Spear Street, Suite 1115 San Francisco, California 94105 (415) 546-1190

Unfortunately, small business' special problems and needs are ignored by the Administration as it seeks to justify the abolition of the SBA and its guaranteed loan programs. The main failing of the budget elimination proposal is that it ignores reality.

The reality for small business today is that it has been crowded out of the short-term bank borrowing market, the primary source of its financing.

The reality is that more capital must be made available for small business if we are to create needed new jobs and continue to reinvigorate our economy.

The reality is that there is a need for a flexible SBA guaranteed business loan program that is attuned to small business needs and borrowing patterns-a program that helps healthy small businesses weather recession and helps small businesses start up and expand during recovery.

The reality is that SBA guaranteed loans are made with private money, not taxpayers' money; that lending decisions under the SBA guaranteed loan program are made by the marketplace and the local lender; that the SBA loan guarantee reduces the element of risk and provides an incentive for the bank to lend to small businesses and help their communities; that the SBA guaranteed loan program has provided an essential safety net for small business-a net that is being shredded by the current budget proposal to eliminate the SBA.

The reality is that the SBA guaranteed loan program makes money for the federal government. The Japanese Government has four agencies that can lend, directly or indirectly, up to $20 billion to small businesses in that country. That demonstrates the importance the Japanese, our major economic competitor at home and abroad, place on maintaining a vigorous small business sector. This is just the type of support we should be providing to our battered small business sector. We can only have a strong, continuing, broad-based recovery if we have healthy and dynamic small businesses.

In summary, the realtiy is the SBA provides essential services to a vital sector of our economy and must be maintained.

I urge you to look closely at these realities and to make a statement of strong support for the American small business community by endorsing the preservation of the SBA and by supporting those SBA programs which most assist the continuing growth and development of small businesses.

Sincerely,

M. Catherine Lyons
Executive Vice President

MCL/pf

February 21, 1985

POPEYES
CHICKEN
& BISCUITS

The Honorable Lowell Weicker
U.S. Senate
Washington, D.C.

Dear Senator Weicker:

We have heard that the Administration has proposed that the SBA be eliminated. This concerns us as we would not have been able to establish our business had it not been for the SBA guaranteed loan which gave us our start. We know there must be many like us, and will be in the future if the SBA is not eliminated.

We are the Popeyes Famous Fried Chicken franchisees for Alexandria and part of Fairfax County. Our business was established in April of 1983 with an SBA guaranteed loan for $550,000.00. The business has done well and we have been able to provide benefits to the community, e.g., we have approximately 65 employees on our payroll, with an average monthly payroll of $35,000.00. We pay an average of $10,000.00 per month in payroll taxes (FICA and federal withholding) and $6,000.00 in state and local sales taxes.

Although we repaid our SBA loan in December of 1984, which enabled others to borrow the same money, we will never forget the SBA assistance we received which made it possible for us to be our own boss. Although we had mortgaged everything we owned to obtain seed money to get our business started, we could not, even with the considerable help of family and friends, have raised the $550,000.00 by ourselves.

Incidentally, our first restaurant's profits have enabled us to establish a second restaurant in Old Town Alexandria, and we have plans for a third and fourth restaurant on the drawing board. Thus, in just another year we will have over 200 employees in four restarants - - all of which was made possible by the original SBA loan.

The longer (20 year) term of the SBA loans is very important to an individual just starting out, because of the lower monthly payment and the uncertainty as to how the business will do.

We hope that you and your colleagues will take into account, when you consider abolishing the SBA, that local banks simply will not help an individual get started in a business unless the individual has significant assets. Most businessmen and women starting out simply do not have sufficient assets in the eyes of the local banks.

Thank you for your consideration.

Sincerely yours,

John Meilert
John J. Meilert

M. J. Copernoll
Margaret J. Copernoll

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15 February 1985

Honorable Lowell E. Weicker
Chairman, Senate Small Business Committee
Washington, DC

Dear Mr. Weicker:

I recently formed a small business--Arrow Computer Supply, Inc.--with the assistance of an SBA guaranteed loan. The business involves the distribution of computer supplies to commercial accounts in Northern California.

I originally sought long-term financing through traditional banking channels but was dismayed to find that even with excellent collateral property my loan request was denied. Numerous banks perceived my acquisition of assets and a customer base from an existing business to be too risky for them. Finally, I discovered First Capital California Business and Industrial Development Corporation who was instrumental in securing an SBA guaranteed loan for me.

The loan has enabled me to adequately fund my new company and in our first year of operation, sales have exceeded $750,000. The Company now employs six (6) individuals and yielded a taxable profit for the year ended 1984.

Needless to say, I am excited about the future propects of my business. None of this would have been possible without the SBA guaranteed loan.

I firmly believe that small businesses contribute greatly to the American economy and that the SBA guarantee loan program should be continued.

Very truly yours,

Anthony G Walker

Anthony G. Walker
President

20 B Pimentel Court, Suite 10 • Novato, California 94947

415-382-0190

SINGER
PRINTING COMPANY

February 15, 1985

Honorable Lowell E. Weicker
Chairman, Senate Small Business Committee
Washington, DC

Dear Chairman Weicker;

We are a small printing firm in Sonoma County, California. Before receiving our Small Business Administration loan, the hope of ever growing and purchasing modern equipment was nil.

Although we made a sizable profit in the first three years since beginning in 1981, local banks and leasing companies turned down our requests for money time after time. They were very aplolgetic, even complimentary as to the future potential and quality of our product. However, they did not want to be the first to take the risk. My feeling was that if I already had the money, they would lend me the money. One conventional lender even advised me to come back to him in two years and he'd then give me all the money I could need. But how was I to get to that point two years down the road.

This is where the SBA plays a crucial role in the development of the American Dream. I started my company out of a garage in 1977, moved to Sonoma County in 1981 and the SBA loan I recently received will generate sales for 1985 of one half a million dollars. I have been able to purchase a 2 color Heidelberg Press, camera equipment, a darkroom and cutter. The new equipment has allowed me to be more competitive in my pricing and has greatly improved the quality of our printed product.

In just three short months, our business is beginning to double and we have needed to hire two more people to help with our work load. And this is just the beginning!!

Who do I have to thank for this? The banks, the leasing companies? No! It is First Capital Corporation, a guaranteed SBA lender, and the SBA for their confidence and assistance. I am endebted to both of them - they have made the crucial difference.

Please do whatever is in your power to continue to help young entrepreneurs in the future!!

Sincerely,

Barry T. Singer

1364 N. McDowell Blvd. Petaluma, CA 94952 (707) 778-1774

Tools-r-us
10251 So. De Anza Blvd., Cupertino, CA 95014 (408) 725-8300

Febuary 18, 1985

Honorable Lowell E. Weiker
Chairman, Senate Small Business Committee
Washington, DC

Dear Mr. Weicker:

Tools-R-Us began in 1980 with a Small Business Administration guaranteed loan. Our first year as a retailer of tools grossed $60,000. We certainly could never have begun our business without the SBA.

In 1982 First Capital Corporation helped us arrange a second SBA guaranteed loan. Sales in 1984 were over $2,700,000. We employ over twenty people.

No bank has been willing to help make our concept become a reality. Someday we hope to be a nationwide organization. Only with the help of the Small Business Administration could we even dream of this goal.

Sincerely,

Donald Lee

imt

ODS
OLD
DOMINION
SYSTEMS inc.
Serving Government and Industry

February 20, 1985

Senator Lowell P. Weicker, Jr.
Senate Committee on Small Business
℅ Mr. Bailey Bannard
℅ Dickstein, Shapiro & Morin
2101 L Street, N.W.
Washington, D.C. 20037

Dear Senator Weicker:

I am writing to you at this time to express my concern with respect to the possible dissolution of the United States Small Business Administration. It is doubtful that our company would be in business today without the support we had received from SBA during our early formative years. During the approximate time frame from 1971 to 1976, Old Dominion Systems, Incorporated, was able to obtain bank financing from the Northern Virginia Bank by borrowing against U. S. Government receivables. Ninety percent (90%) of the loans we received, collateralized by our receivables, were guaranteed by SBA.

Our latest fiscal year, which ended on October 31, 1984, shows that we had revenues of about $13,600,000 on which federal and state taxes in excess of $400,000 were paid. At the present time we have some 200 employees residing in the District of Columbia and the surrounding counties in Virginia and Maryland.

I urge you to allow this agency to survive and continue its good work.

Very truly yours,

OLD DOMINION SYSTEMS, INC.

J. G. Hartwell
President

JGH:llc

4 PROFESSIONAL DRIVE • SUITE 119 • GAITHERSBURG, MARYLAND 20760 • TELEPHONE (301) 948-5200

COMPUTER DESIGN SERVICES INC.

9487 SILVER KING COURT • FAIRFAX, VIRGINIA 22031
TELEPHONE (703) 385-3707

February 21, 1985

Senator Lowell P. Weicher, Jr.
Senate Committee on SBA
Washington, D.C.

Dear Sir;

I am writing this letter in order to offer my opinion on the benefits of the SBA. We have been in business for four years, with my partner and I providing capitalization coming from personal loans. Our initial capital equipment purchase was financed by the manufacturer at 24% interest rate. Two more purchases of capital equipment were also financed by the manufacturer at 24%. The amount of these loans was approximately $170,000.

After two years of operation, we approached several banks in order to acquire refinancing to reduce our interest payment burden. For the most part they were unreceptive, although our records showed an excellent credit record, sales growth, and backlog. Finally, a small bank in Fairfax agreed to back us with SBA approval. We were approved and received a loan for $160,000. This loan reduced our monthly outlay of cash from $4,800 to $2,800 and gave us much-needed room to expand in a growing marketplace.

We have recently purchased an additional computer system, and have further expanded our services which opened new customer fields.

I would hesitate to say that we would not be in business without SBA backing. However, the $2,000/month that the first loan allowed us, did place us in a position to expand into the new area and hire new people to help staff the operation.

Sincerely,

Richard J Rosica

Richard J. Rosica
President

RJR/kdep

ALSTON

6291 WAREHOUSE WAY SACRAMENTO CA 95826
916 381 3291

February 15, 1985

TO WHOM IT MAY CONCERN,

ALSTON INDUSTRIES, INC. is a small manufacturer in an extremely automotive after- vertical market. Because of the nature of the market, tremendous amounts of capital must be spent both on advertising and promotion (in excess of 14%) continually. In addition over 5% must be continually plunged into ongoing R & D. ALSTON INDUSTRIES, INC has a commitment to remain on the leading edge of technology in the field of race car development and it is at best a very expensive propositon.

ALSTON INDUSTRIES, INC has been in business for over eight years and we currently employ 30 people. Our current yearly sales are in excess of two million dollars and with the release of our new disc brake technology the volume should double within a short time.

The new brake technology we have developed and have in the PATENT PROCESS will allow the traditional OE manufacturers to build brakes calipers that will save over 25% of the weight over the current calipers in use. This will translate into greater fuel efficiencies.

Without the assistance of the SBA loan funds it would be virtually impossible to bring about the technological advances fast enough (if at all) to be of any significant use to the AMERICAN CONSUMER.

It is with this concern in regards to the SBA program that I am communicating our feelings in regards to the proposed elimination of the SBA.

Regards,

Thomas A. Alston
PRESIDENT
ALSTON INDUSTRIES, INC.

TA/at

The **CHAIRMAN**. Thank you.

You mentioned or alluded to the fact of some of the figures being misleading. Again, I do not want to get into this in-depth because I want Mr. Stockman to be here to respond himself, but I will just dwell on the one that you mentioned.

In the materials handed out to the media, Mr. Stockman indicated default rates of 19 percent in 1979, 23 percent in 1980, and 19 percent in 1981. Now that is not the loss rate.

Mr. **BARNARD**. That is correct.

The **CHAIRMAN**. The loss rate is what the taxpayer should be concerned with.

Mr. **BARNARD**. Correct.

The **CHAIRMAN**. The loss rate is somewhere between 5 and 6 percent.

Mr. **BARNARD**. If you also take into consideration the money that is actually generated out of the program, that loss rate is——

The **CHAIRMAN**. That is correct.

Let's take just his basic figures. Mr. Stockman indicated to the media that the payout on these defaulted loans totaled some $4,247 million—that is a half-truth; nothing could be clearer as the definition of a half because you know as bankers sitting there—that without any mention at all of the revenues collected through servicing liquidation—this figure is misleading. The actual figure of loans charged off totals over that period of time, from 1972 to 1984, some 12 years, is $1.4, not $4.2 billion.

It seems to me that the least that can be expected of the Director of the Office of Management and Budget is a total accuracy with figures. If he wants to editorialize, that is his business. He is accountable to his superiors on that matter and to the Congress. But the figures he uses should be totally accurate.

The figures that we have cited here in terms of default rate and loss rate—in terms of payout on defaulted loans minus the revenues collected through liquidation—these are accurate figures. We are not trying to use the figures to sell our picture—or, if we are, at least they are complete figures and not half.

Senator Bumpers, do you have some questions?

Senator **BUMPERS**. Mr. Chairman, before I get into some questions, I would like to elaborate to some extent on what you just got through saying.

Mr. McCormick and Mr. Mitchell, I would say to you that if you were the U.S. Treasury and you were making these loans and had a 6-percent default ratio—loss ratio, not default ratio—but you were also getting all the income taxes that that corporation paid and that the employees of those corporations paid back into your treasury, it would be one fine deal for you, just as it is for the U.S. Treasury.

[Mr. Mitchell, Mr. McCormick, Mr. Bennett, and Mr. Barnard nod in agreement.]

Senator **BUMPERS**. That is the reason this whole thing makes no sense.

I understand that in the public relations department David Stockman may win this battle. I don't think he will but he might. But even though those of us who feel strongly about this program, that it is cost effective for the United States, we may lose the publicity battle, even though we salvage SBA.

I want to reemphasize the point that I made earlier this morning, and that is that Senator Weicker and I have cut our reauthorization bill very dramatically. We have frozen employment within the agency, and we have taken some other very stringent measures. Frankly, the thing that we save and the thing that is most vital to save is the Guaranteed Loan Program.

This testimony this morning has been one of the most interesting. One of my colleagues on the Democratic side of the aisle lost his Senate seat last year I think because his opponent pointed out that he never attended certain committee meetings. I never cease to be amazed at what plays in politics anymore, but, of course, No. 1, it is impossible for us to attend three committee meetings that are all going on at the same time. I think after that loss last year, most of us this year, Senator Weicker, are probably just going to be sticking our head in the door saying "Present," and then going to the next one and saying, "Present." [Laughter.]

So that we will not be subjected to that kind of a misleading campaign in 1986.

But there is another reason, and that is because a lot of Senators introduce rather trivial and meaningless legislation so they can send press releases back home, even though they know their legislation isn't going any place. It is usually of parochial value anyway.

A third reason is because this is where the real work is done, and some Senators do shirk their responsibilities about it. One of the reasons they shirk their responsibilities is because so many committee meetings are rather dull, uninspiring, and uninstructive. I want to say to you, gentlemen, and to the panel that just left, that this has been one of the most instructive, helpful committee meetings I have ever attended.

I have been ranking member of this committee for some time now, and yet I have learned so much this morning, particularly about the success of SBA, because all you ever hear is what the default rate is. Nobody has ever really come here and put SBA in the proper light, as has this panel and the one preceding it.

We are going to hear OMB and others give us another version of it. That is what pluralistic society is all about. But it seems to me that an awful lot of bankers in this country certainly ought to tear a page out of your book and take advantage of the program not just to help small business, but to help themselves. Obviously, this has been a very good program for all of you.

Don't you often say to an applicant for a loan or somebody who starts up a new business, maybe he has a good idea, you like the idea, you think it has promise, but you think it is marginal if you have to go to your own board with it and ask them to approve it? But you say to that applicant, "Look, if you could get SBA to participate in this loan, I feel sure, and I would be willing to go to the mat with my board for this loan. It is a slight risk for us, but if you can get an SBA guarantee, we'll go with it." Is that the way it happens many times or not?

Mr. McCormick. Yes, sir.

Mr. Mitchell. Very often.

Senator **Bumpers**. Let me ask you this: If that is the case and your default rate is as low as it is, your judgment has obviously been extremely good but perhaps no better than others who would be willing to get involved in this program.

Mr. McCormick, how does your bank rank in the community of Stillwater?

Mr. **McCormick**. We have approximately 60 percent of the market. Fifteen years ago——

Senator **Bumpers**. Let me rephrase the question. How many banks are there in Stillwater and where do you rank in the assets?

Mr. **McCormick**. There are three banks in Stillwater. We have $170 million. There is a $110 million bank and there is about a $45 million bank.

Senator **Bumpers**. You are the biggest bank?

Mr. **McCormick**. Yes; we did not used to be.

Senator **Bumpers**. You have become so under your brilliant tutelage? [Laughter.]

Well, I heard Senator Nickles this morning pointing out phenomenal growth rate your bank has experienced.

Mr. **McCormick**. Yes, sir.

Senator **Bumpers**. How about you, Mr. Mitchell, how do you rank?

Mr. **Mitchell**. We were the smallest bank when we started this program. We were the fifth out of five banks in Baton Rouge. Of course, we've gotten a lot of other banks since then.

One of the reasons we became so interested in the SBA was because we were at a disadvantage being the smallest bank in town at that time, and the use of this program really gave us an opportunity to compete with the bigger banks at a time when that was so vital to us.

At the time that we went into the program we were about, I guess, a $75 to $100 million bank. As I mentioned, now we are about a $540 million bank. We can compete a little bit better.

However, back then, and for other banks in our situation where you are the smaller bank in town type thing, this program is just invaluable because you can make big loans. A $500,000 loan to a small bank is a big loan, and you can do that where your bottom line risk is $50,000 if the world ends, but you cannot do that if your bottom line is $½ million. It just gives you a whole new ball game to play in.

Senator **Bumpers**. Incidentally, what is your rate right now on guaranteed loans, interest rate?

Mr. **Mitchell**. The variable rate loans are running between 2 to 2.5 over the lowest New York prime rate, which would put it at about 13.5 to 14, if my numbers are still right. They are about the same or very similar to what we would make on a nonguaranteed loan.

Senator **Bumpers**. Of all the people who come into your bank, and I will ask you the same question, Mr. McCormick—of all the small business people who come to your bank with applications, how many of those that have been approved by SBA do you reject?

Mr. **Mitchell**. Well, it works in reverse. They have to come to us first. We have to recommend them to SBA.

Senator **Bumpers**. OK, and once SBA recommends them——

Mr. **Mitchell**. No; we have to submit them to SBA. We have to say, "We will"——

Senator **Bumpers**. Oh, so you have to approve on the front end; that is what you are saying?

Mr. **Mitchell**. That is correct. We have to approve first, yes.

Senator **Bumpers**. OK

Mr. **McCormick**. I might want to add, Senator, that upon occasion the SBA will reject one which we have approved. We have not found them to be extraordinarily liberal lenders. They generally make a lot of sense——

Senator **Bumpers**. That is an interesting comment, Mr. McCormick.

Mr. **McCormick** [continuing]. At least in Oklahoma. They don't want to make bad deals any more than we do.

Mr. **Bennett**. Senator, one of the other things which I think was said before today but should be restated is that the SBA's guarantee does not make a bad loan good. It allows a longer term payout. In our case we emphasize a fixed rate, not wanting our small business borrowers to take the risk that the rates will rise rapidly. It makes a loan able to be paid out over a longer period of time to make a small business viable, a good small business viable.

Senator **Bumpers**. You come in that 82 percent of the 8,900 banks surveyed that say you either would not make these loans or you would make them under much more stringent conditions?

Mr. **Mitchell**. Absolutely.

Mr. **McCormick**. Yes.

Senator **Bumpers**. I have one final question for any of you. Probably, Mr. Mitchell, you and Mr. McCormick can answer this better. Give me the procedure for the sale of these loans. Now you have both indicated that you resell these loans. No. 1, do you sell them without recourse? Your exposure is only 10 percent.

Mr. **Mitchell**. That is correct.

Senator **Bumpers**. But do you sell them without recourse, No. 1? No. 2, do you retain an override?

Mr. **Mitchell**. Yes, in our case in both cases you sell without recourse because, of course, it is a guaranteed document. The buyer has no risk anyway. He is buying only the guaranteed portion.

Senator **Bumpers**. He only buys the guaranteed portion?

Mr. **Mitchell**. The originating bank——

Senator **Bumpers**. So you retain your exposure?

Mr. **Mitchell**. You have to keep your risk; that is correct.

Senator **Bumpers**. OK.

Mr. **Mitchell**. So the recourse factor is a moot point. The override, generally yes, we are able to sell quite often, especially in the case of a variable rate loan. If you make it at 1 to 1.5 to 2 over prime, it is not difficult to sell it at prime to the investor, because he is buying this Government security really.

Senator **Bumpers**. You continue to service the loan?

Mr. **Mitchell**. We continue to service it, and, of course, for that we get the override, and, of course, we also have the risk involved in the 10 percent.

Senator **Bumpers**. I will tell you, if I were a banker, I would be deeply involved in this program, I think.

Mr. Mitchell. Senator Bumpers, we have been preaching what we call "the gospel of SBA." Our bank started very early, and we have crossed paths with Mr. McCormick, who has done the same thing. We have preached this and preached it and preached it.

Again, you were talking a while ago about the public relations thing. The opponents of SBA, be it wittingly or unwittingly, have done such a good job that there are banks that, when you say SBA, if you yelled "Fire," they would sit there and burn.

Senator Bumpers. I think that is the rule. That is the rule in this country.

Mr. Mitchell. That is exactly right.

Mr. McCormick. I would want to add that we have found the SBA to be very responsible as far as our dealings with them go. Certainly in Oklahoma, which is all we can speak to, they don't deserve the reputation that they seem to have received out there.

We are very much aware that this is a public program, and it is a program in which there should be wide participation. Frankly, we are not entirely comfortable with the fact that we dominant the market in Oklahoma the way we do. One of the reasons why we had the seminar was to try to exercise good citizenry, if nothing else, to bring the rest of the banking industry in and say, "Look, we are doing this. It is a public program. It is available to you, and you may do it, also." Of course, we also told them we would do it on their behalf, and so we had a proprietary interest in doing that, but we shared the information with them, in the hope that they would get involved. I think if you had a broad-based environment, it would help ensure the continuation of the program. That has been our attitude in regard to it.

Senator Bumpers. If I decide to hold hearings in my State on this issue, both because of the pending legislation and OMB's proposal to abolish SBA, I would hope to get a lot of my banks in, and I would like to invite at least you two gentlemen to come down there to testify to preach this gospel, because I don't think it is widely understood in my State.

Mr. Mitchell. I would like to make just one other comment, if I may. You talked a while ago again about the public relations situation. One of the real problems that you cannot get a lot of good knowledge for SBA is that the small businessmen who have been served by SBA, they are not going to come here, they cannot afford to come here to begin with to testify, those who are at a distance. They have their businesses, and they are gone and they are happy. The others do not even know that they are going to need it. So you really do not have a segment that is saying, "We need to keep SBA alive." Until you need it, you do not realize you need it. After it has served its purpose, these people, many of them to whom we have made the initial SBA loan have come back later on for their normal, short-term financing, and we do not use SBA; we do not need SBA for that. You do not have a large group that will stand up and cry and say, "Keep SBA alive."

Senator Bumpers. That is right.

Mr. Mitchell. We know because we have seen both sides and we know the need. You are not going to get a lot of voices, but it does affect a lot of people.

Senator **Bumpers**. Like a good wife, you don't really miss them until they're gone. [Laughter.]

The **Chairman**. Well, you know, that is the problem. Let me state it right now. that is the problem in the country as a whole, not just SBA. An awful lot of people out there got a college education with student loans, and they are making a lot of money nowadays and you don't hear anything from them now that somebody else's student loans are going to be cut.

Mr. **Mitchell**. It is the same thing.

The **Chairman**. An awful lot of people have benefited from a program that has been a 100-percent success, at least in my State and I think across the country, which is elderly housing. Some housing projects have not succeeded. A lot of people have a roof over their heads that would not have had a roof over their heads except for those programs. I don't hear them speaking up for other people who need a roof over their heads.

As Dale has, I have just been inspired by the stories that have been told here. What this represents is probably far more the norm of what is going on within the small business community. It is very easy to tar somebody. People like to bathe in sensationalism and think that typifies the whole program, whereas really the norm is being enunciated very undramatically here, but very eloquently, by the stories that have been told.

This is the question I have for all of you: It goes beyond those that have gotten a small business loan because you have made the point that the resale of the small business guaranteed loans allowed you to make loans to small businesses without a guarantee. What percentage of your small business portfolio is SBA guaranteed, and by what percentage has resale allowed you to expand your lending to small businesses that are out of the scope of the SBA program?

Mr. **McCormick**. I would like to refer my answer to Mr. Bennett on that.

Mr. **Bennett**. I was just going to look to see.

The **Chairman**. You can give a specific answer for the record. I am not trying to lead you; you speak for yourself. If I am not mistaken, there are considerable dollars involved there which would not be available to a small business community outside the SBA progam were it not for this guarantee; am I correct or not?

Mr. **Bennett**. That is absolutely correct; yes, sir. Our ability to make and sell the SBA guarantee on the secondary market has allowed us to significantly build our community that we would not have been able to do without that opportunity to recapture our dollars and loan them again.

The **Chairman**. Those are the blue dots on this map?

Mr. **Bennett**. That is right.

Mr. **Mitchell**. I do not have the numbers as far as the percent of SBA's to our total loans, but we have probably sold, I would say, 90 percent of all the SBA loans we have made. Rounding off to $70 million, 90 percent of that would be somewhere around $62 million. This would represent money brought in from outside of our State to put back. Of course, we are loaned up to here [indicating the top of his head]. This money, $60-something million, would have been put back into our area from outside of our State, which, incidentally, is something else that makes it attractive to bankers because it is much more comfortable to bring that money in that way because it is going to be in there for the next 10, 15, 20, or however long you have that loan; whereas, if you try to attract deposits to fund loans, it may be gone next week. It is a tremendous tool for a smaller bank, for any bank for that matter.

The CHAIRMAN. I might add, to again set the record straight in the information given to the media by OMB, the statement was made by OMB that SBA loan subsidies go mostly to economic straphangers, weak businesses that get repeated SBA loans. OMB used the figure that 53 percent of 1982 SBA borrowers were repeat customers and 77 percent of 1983, the first half of 1983, SBA borrowers were repeat customers.

The actual figures—the actual figures—are: 14.4 percent of the 1982 SBA borrowers were repeat customers, 16.4 percent of 1983 SBA borrowers were repeat customers, and 13 percent of 1984 SBA borrowers were repeat customers.

I want to repeat that the 53 and 77 percent figures that was quoted out of there is statistically, factually wrong.

Mr. MCCORMICK. I would also want to add that, after all, probably 95 percent of our loan customers in our bank are repeat customers. [Laughter.]

You have an ongoing relationship with people. This isn't, you know, just a blind date. [Laughter.]

You have an obligation to go on with these folks and work with them as they go through their economic life. It would be true on either side of the ledger.

Mr. MITCHELL. I was going to say almost the same thing a different way. Ninety-nine percent of any second SBA loan is because the first one was very successful, and this business is now growing to another tier and needs additional financing. I would say that virtually nobody in his right mind would make a second loan because the first one is bad. You just don't do that, whether it is SBA or otherwise. If there is some repeat lending, it should be viewed as a positive reaction, not a negative one.

Senator BUMPERS [acting chairman]. Gentlemen, I have asked all of the questions that I had, as has Senator Weicker. Let me thank you again for your very timely—yes, Mr. Mitchell?

Mr. MITCHELL. Excuse me, please. I have three letters I received to the IBAA from other banks. Could I put these in the record?

Senator BUMPERS. Absolutely. They will be admitted without objection. I appreciate that.

[Material follows:]

FIRST NATIONAL
BANK of Clinton

February 14, 1985

Additional copies to: John Danforth
Ike Skelton

The Honorable Thomas Eagleton
107 Dirksen Building
Washington, D.C. 20510

Re: Reagan Administration Elimination of SBA in 1986 Budget Proposal

Dear Mr. Eagleton:

I would like to call your attention to the above referenced matter. The Small Business Administration, as the only non-regulatory governmental agency, provides perhaps the best application of tax dollars to stimulate economic growth of any federal entity.

In our small community bank alone, in a town of 8,500, our portfolio of SBA loans has helped 30 businesses finance their operations; employ over 150 people; and generate annual sales in excess of $10,000,000. Considering the number of times each dollar "rolls-over" in our community; the impact is substantial. Also of value to our area is that several of these businesses are wholesale, tourist, and regional related businesses, allowing an influx of "new money" into our economy.

Our financial institution supports budget programs to eliminate the federal deficit. Within this philosophy, however, programs must be evaluated on their merit, significance to local economies, and generation of tax dollars. I recommend the elimination of non-effective SBA programs such as direct lending and non-physical disaster loans.

I can understand that perhaps from a big city perspective, such as Mr. David Stockman's, that SBA programs assist undeserving businesses and the number may be small. However, let me assure you and your constituents, that the inpact on our community is significant. I have enclosed for your review a resolution prepared by the Independent Bankers Association of America and encourage your adherence to this position.

Sincerely,

Ron Arthur
Vice President

P. O. BOX 606 CLINTON, MISSOURI 64735 MAIN BANK (816) 885-3365 BRANCH (816) 885-6166

Bankers'
Bank
OF WISCONSIN

February 14, 1985

COPY

The Honorable Robert Kasten
United States Senate
Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Kasten:

In this nation's love affair with big business and large scale success stories, it is often easy to overlook the thousands of small business contributors to our economy. The prospect of losing the Small Business Administration which has been a bootstrap for many small businesses is distressing and frightening.

As a banker working with small business, I have used the Small Business Administration on numerous occasions. Because of the S.B.A. I have seen businesses which could never have begun, flourish, add employment, provide an economic benefit and pay taxes. An agency such as the S.B.A. has provided encourgement and advice to small business and, sometimes, imposed the outside discipline needed to make a venturist a business person.

Small banks in particular benefit from the S.B.A. Small banks cannot afford to take the venture capital risk to promote new business creation--the S.B.A. has provided a means. In this day of massive government budgets, deficits, give away programs and bureaucratic excess, a small budget item that is as useful as the S.B.A. should be allowed to continue and perhaps expand.

I regret that the statistics are not available to me, but I think it would be a safe wager that the taxes paid by businesses, their employees, suppliers, and creditors pay for the S.B.A. costs over and over.

This nation's greatness was built on the individual efforts working toward a combined benefit. Let us not become so large, that we lose sight of our base roots. Please support efforts to maintain the Small Business Administration.

Sincerely,

Helge S. Christensen
President

HSC/as

Ken - for your info.
Same letter to Proxmire and Rep. Kastenmeier

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February 13, 1985

Mr. Donald Regan
Senior Staff Advisor
The White House
Washington, D.C.

Re: The Small Business Administration

Dear Mr. Regan:

Last week I had occasion to call the Springfield office of the Small Business Administration. I was shocked to learn that SBA is to be terminated. I promptly called the offices of Senator Alan Dixon, Senator Paul Simon and Congressman Kenneth Gray to ask them to please make every effort to keep the SBA in business.

You, Mr. Regan, with your background in the large business world are perhaps unaware or insensitive to the needs of the small businesses of America. Admittedly, SBA has had far too many bad loans, however if you will look into the background of those loans on a broad basis, you will discover that as a result of Congressional pressure of five, six, eight years ago, on SBA to make social program related loans that were really not credit worthy to begin with and therefore the loan losses were very large. Congress itself is to blame for that result and not the SBA. If all SBA loans were made on a proper credit worthy basis, with the degree of risk evaluated carefully, those loan losses would be sustainable. If the SBA program has flaws as now constituted, then lets correct those flaws but not destroy a very important and necessary organization that contributes much to the small business firms across this country.

The SBA is the primary source of risk money for the small business firms across this country. If you shut out that source of funding, then you destroy the opportunities for creation of jobs in the small business world.

I know my one small voice crying in the wilderness will probably have no effect on you or Congress, but it is a grassroots feedback to you and those in Washington. I run a small $25 million country bank and I see the needs and the problems of small businesses.

I recognize the drive behind this action to help to balance the federal budget. I totally agree with balancing that budget and don't take four years to do it. It seems reasonable to me that when America sends Congress 800 billion dollars to run the country, it certainly ought to be a good enough manager to make those funds do the job and not have to borrow another 150 or 200 billion dollars. This is ridiculous and if it was in the private sector, managers that were coming up with that result would be promptly terminated.

I am sending copies of this letter to Senator Alan Dixon, Senator Paul Simon and Congressman Ken Gray from Illinois to hopefully encourage their support of modifying or correcting SBA if it has shortcomings but keeping it in business for the good of small businesses across America. Also, I am sending a copy to Vice-President George Bush, because from every indication that I see of him, he is a person of sound financial judgement.

In closing, I beg of you to do all that you can to keep the Small Business Administration alive and healthy.

Yours sincerely,

Bruce Burnett

Bruce Burnett
Chairman

BB/pb

CC: Vice President George Bush
Senator Alan Dixon
Senator Paul Simon
Congressman Ken Gray
Stephen J. Veerdier, IBAA, Washington
Don Brookhart, SBA, Springfield, IL

Senator BUMPERS. Thank you all again for coming up to be with us this morning. Your testimony has been extremely good and very helpful to this committee.

Our next and last witness is John Sloan, who is president of the National Federation of Independent Business.

Mr. Sloan, welcome to the committee this morning. Thank you for being with us. You may proceed.

STATEMENT OF JOHN E. SLOAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, DC

Mr. SLOAN. Senator Bumpers, thank you very much. I appreciate this opportunity of being here, and particularly to have the opportunity to share some thoughts on the SBA proposals as we, on behalf of approximately 550,000 business owners, see the area.

As you probably have my more in-depth prepared statement with you, I will not go through that, but will really hit some highlights.

To put it in a bit of perspective of where NFIB is coming from, over the years NFIB has had a consistent policy toward fiscal soundness on behalf of the Federal Government. We believe at this point that cutting the deficit an appropriate amount, $50-odd billion, is important—probably the most important thing that could be done to help small business across the country maintain its momentum as the country's powering machine. In that context, certainly we want to look at all parts of the Federal budget where we can save that $50 billion.

We think we have also been consistent over the years in being one of those groups trying to be statesmanlike about our approach in that we certainly think that we should look at that part of the budget that affects us and affects our members.

The precedent was somewhat set 4 years ago when we appeared before this committee and supported a major cut in SBA expenditures of some 20-odd percent. So we really believe that there is a history of NFIB approaching it and being willing to participate in the sound fiscal operation of the Government.

We appreciate the opportunity offered us by the chairman and by yourself to come, though, and lay out why we think at this time that Mr. Stockman is not taking the right direction. We understand, we think, what they are trying to accomplish there, but we certainly believe that the idea of abolishing the SBA is not the way. The comments that I will make here, though, are in the context of making every effort to reduce spending and having the SBA play its share in that, but at the same time maintaining what we believe is a very viable agency in serving a major sector of this economy, and that sector that really kept us from worse unemployment in the late seventies and early eighties and, frankly, has created the jobs to reduce the unemployment figures as we see them today.

As a result, we are suggesting the maintenance of the agency. We appreciate what you, Mr. Chairman, and Senator Bumpers are suggesting in an approach to that. Our suggestions, frankly, fit in that vein. We think there are some parts of the SBA that reasonably can be eliminated. We think there are other major programs that can be improved and streamlined and yet are effective enough that they should be maintained.

Frankly, prior to coming to NFIB 18 months ago, I spent 22 years as a commercial banker, so I particularly enjoyed myself the testimony from this panel just prior to me, and agree with many things that they had to say.

First, however, I think that we need to look at a program that has not worked as well as the Guaranteed Lending, and that is the Direct Lending Program. It is NFIB's position that the small business community would strongly support abolition of the Direct Loan Program. We applaud you all for taking the suggestion that we back out of that area of SBA involvement. The loss rate indicates that there are a lot of loans being made out there that should never have been made which are causing emotional distress to families because they were given those loans that really should not be made.

Senator Bumpers, I must say here that we include in some of the programs we would like to see the SBA out of is the farm disaster lending area. Frankly, in my own experience as a farmer in southern middle Tennessee, I have seen some of my neighbors put under more stress because they were given loans which ultimately put them out of business. The SBA, making those loans in a hurry, has led to a lot of default, a lot of Government expense, while really creating havoc back in the farming community. So we would urge the elimination of the Farm Disaster Loan Program within the SBA.

Two programs we would urge maintaining, but under a vastly restructured basis: First would be in the area of management assistance. Last year we employed Tarrance & Associates to do a rather in-depth study of the whole area of management assistance, and it was initially to find where we saw real cost-effective work being done.

It is interesting, for only a cost of about $1 million, that the SBI's are, on a job-by-job basis, getting some productive work done.

Those members who responded to our survey also indicated that they principally liked to turn to the retired executive, the professional consultant. We appreciate the authorization last year that gave the SBA the right to deal with for-profit consultants.

We see that there are a number of areas around the country where, when developed properly, programs such as the SCORE Program can work at a very, very minimal cost. We see those areas also worth saving.

Now the big program, and the one that you have just spent the past hour looking at in some depth, the 7(a) Guaranteed Loan Program, is one that I, frankly, would urge you to stick to your guns on here, and let's see if we can save that program. We believe it can be spruced up and made substantially more cost efficient and less of a burden to the taxpayer.

The data that we have at NFIB support what we were hearing before, that when you get down to the true loss rate —and, Senator Weicker, I appreciated your comments and questions there—to the point that the real loss rate is down in the neighborhood of 5 percent, not the figures that we have been getting on that area.

We do believe, however, that program can be more of a user-paid-for program by enlarging the fee. We think a 1-percent fee is really not a realistic one out in the real world marketplace today. We would urge that you consider a fee of 5 percent. On a $2.5 billion authorization, that would be $100 million to help cover the cost of that program, and on a loss rate of under 5 percent, would come very close to making it a user-paid-for program.

In my experience as a banker, I lived with that. That is how the FDIC operates. That is a user-paid-for program, but it is a Government agency.

We would like to see the 7(a) program maintained in that type of a vehicle, take off the cost to the taxpayer, but keep the program for the many reasons we have just been hearing.

Let me wrap my comments up before questions by mentioning that there are two programs we specifically would like to see maintained, and not maintained in the Commerce Department but as part of a freestanding small business representative. Those are in the areas of procurement, where I do not think there is any question but that that program is cost-effective to the Government. For every dollar of cost to the procurement department, we perceive that there is a $6 gain in lower cost of procurement to the U.S. Government, obviously a bonus to us all.

Second, a very low cost program has been the Office of Advocacy. I think their budget has only been in the neighborhood of $5 million with all they are doing. We urge the keeping of the Office of Advocacy as the small business independent voice here in Washington. We do see some ability, again, to trim that a bit. We do not see a real need for maintaining a regional network that really is not a part of the real voice and work taking place here in Washington.

Finally, we would like to suggest an addition. We believe that if those of us in the small business community are willing to stand up and take our licks first, be a part of this effort to get the budget under control, but urge the keeping of a small business voice and representative here in Washington, we would like to see that person having the same level of recognition as our Trade Representative. We would like to urge you to consider elevating the position to that, which would be comparable to Cabinet status.

I appreciate the chance to share these remarks, and will be happy to try to deal with any questions you might have.

[The prepared statement of Mr. Sloan follows:]

NFIB® National Federation
of Independent Business

The Guardian of Small Business

STATEMENT OF
JOHN E. SLOAN

PRESIDENT and CEO

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Small Business Committee

Subject: The Small Business Administration

Date: February 21, 1985

Mr. Chairman, on behalf of NFIB and its more than 500,000 small business members, I thank you for this opportunity to appear before you and share with you my thoughts on the Small Business Administration.

NFIB has testified many times before on the SBA, and we have been a frequent critic. The agency has had major problems in the past, and it continues to do many things it should not. Much of what it should do, it does poorly.

For anyone who has read between the lines of our past criticisms, or for anyone who might for any reason misinterpret our recent statements on the question of the proposed abolition of the agency, let me state for the record that NFIB opposes any and all efforts--by the Administration or any other source--to shut down the SBA. What we seek is improvement, not elimination.

Federal Legislative Office
600 Maryland Avenue, S.W.
Washington, D.C. 20024
202 554-9000

OMB Director David Stockman has proposed the abolition of the SBA as a deficit reduction measure. We could not agree more with Mr. Stockman that the deficit must be reduced and reduced drastically. In fact, cutting the federal deficit is our member's number one priority, as we have made clear both in Congress and throughout the executive branch.

Mr. Stockman is aware of studies by NFIB and others that show the majority of small firms in this country do not use SBA programs and therefore do not benefit directly from the agency's existence. He is also aware that NFIB and others have expressed dissatisfaction with the agency's performance and have striven to modify or eliminate some of the SBA's programs. Add these factors together with the critical need for fiscal restraint, and it is not difficult to understand how the conclusion was reached that the SBA could be eliminated with minimal economic and political impact.

Unfortunately, this logical conclusion is based on a shortsighted, if not false, premise. We in the small business community do care what happens to the SBA--that is precisely why we have been critical and will continue to be critical. SBA serves a myriad of purposes, not all of which can be seen by the casual observer. The SBA is the only federal agency charged with the responsibility of protecting and promoting the needs and concerns of small business. It has no other mission, no other consitituency to confuse or diffuse its efforts. Direct, hands-on assistance to individual firms is only one facet of the SBA. Equally, if not more, important is the role the agency plays in helping create a healthy environment for small businesses to grow and thrive.

Whether or not you suscribe to the belief that government should not intervene in a free marketplace, widespread government intervention is a fact. The SBA plays a vital role in helping to minimize the harmful effects of this intervention by watchdogging other federal agencies to ensure small business capabilities, problems, and needs are considered during the rulemaking or policymaking process. Similarly, free and open competition is a rare phenomenon in the federal marketplace, where sole source contracting is standard operating procedure. The SBA has saved the nation's taxpayers millions of dollars, expanded our shrinking defense industrial base, and opened up a profitable market for small firms by identifying new small business contractors and contracting opportunities. Further, the SBA educates people in the government and in the private sector about both the vital role small business plays in our economy and the real differences that exist between large firms and small firms. The result: more informed, more responsive economic policies can be developed for the nation's benefit.

These are examples of ways in which the SBA continually seeks to aid and assist small business. But the effects of these activities are often difficult to trace, as they are by nature efforts that go largely unnoticed by the general public. This might help explain, however, why a majority of the small business community can say that the SBA has no direct impact on their businesses, yet the agency enjoys a positive overall image with its constituency. The perception of small business owners is that the SBA is "ours", its greatest strentgth being its concern for small business.[1]

Small business cares about the SBA, so at least part of the premise upon which the Administration based its decision to eliminate the agency is faulty. But what about the other part, i.e. elimination of the agency is necessary to cut the deficit? Unquestionably, an agency which does not exist cannot spend money. What disturbs us most, however, is the shortsighted approach Mr. Stockman has taken to solve a long-term problem. The Office of Management and Budget claims significant savings of $5.3 billion over a three-year period, which figure presumably includes the sale of the SBA loan portfolio. OMB projections were a return of $2.1 billion on a $12 billion portfolio, in other words, 19¢ on the dollar.

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[1] See, William J. Dennis, Jr., and Sally L. Douglas, Small Business Evaluates SBA (San Mateo: NFIB, June, 1984).

By contrast, if the SBA were continued and did nothing more than service outstanding loans, the government could recover at least $7.5 billion over a five-to-seven-year period. Shutting down the agency and selling off its portfolio would cost the taxpayer, in lost loan repayments, almost exactly the amount OMB is claiming would be saved.

Let me take it a step further. A member of ours, Mr. James A. Bettersworth from Sequin, Texas, recently sent us a comprehensive proposal for restructuring the SBA. In the proposal, he talks about a banker from a small town in Connecticut who wrote to President Reagan about his bank and its portfolio of 100 SBA-guaranteed loans, valued at approximately $10,000,000. In attempting to analyze for the President the economic impact of these loans, he provided the following profile:

Gross Sales - $40 Million +

Number of Employees - 1600

Federal Taxes Paid - $ 1 Million +

Mr. Bettersworth expands upon this profile in the following manner:

> If the SBA and the private lenders which participate in SBA loan and investment programs currently have over 417,000 loans

outstanding, and if the above bank's 100 loans provide an accurate profile of the typical SBA borrower, then those 417,000 loans produce the following results:

Gross Sales	-	$208,500,000,000
Number of Employees	-	6,672,000
Federal Taxes Paid (business only)	-	$ 4,170,000,000

Those 6,672,000 folks employed by businesses with SBA loans probably pay some sort of federal income tax. Suppose each employee only paid $1,000 in federal income tax. The result would be an additional $6,672,000. If the writer's math is correct, a program that costs $1,000,000,000 a year produces tax revenues of more than $10,000,000,000 per year. Reducing the cost of SBA may make sense. Participation by SBA in reducing the federal deficit may make sense. Eliminating the SBA does not make any sense at all.

We couldn't agree more with Mr. Betterworth's conclusion. There are ways to restructure, refine, and thereby reduce the cost of the SBA which will cut the deficit without sacrificing essential services.

On January 3, I held a press conference to alert the media to NFIB's opposition to the Administration proposal and to outline our own proposal to restructure the agency. Our proposal combines up-front savings--reducing the current SBA budget by well over half--with additional savings and generation of new revenues in future years. We offer our proposal for the Committee's consideration.

Direct Loans

First, we propose to eliminate SBA's direct lending programs. Historically plagued by high default rates and a very high cost of delivery, the direct lending programs at SBA are a luxury we can no longer afford. Less than 3000 loans are made each year with direct funding, and their elimination will not severely damage the small business community. By eliminating all direct loans, we could save $257 million in FY 86.

Included within the direct loan programs are two programs which deserve special attention, i.e. the Minority Enterprise Small Business Investments Company (MESBIC) debenture program and the 503 development company debenture. While we feel the necessity of weaning the SBA from all direct lending, we recognize these two programs as having proved merit as economic development tools. Perhaps a restructuring of these two programs will allow for their being folded into the guarantee programs, or some other instrument can be developed for secondary market saleability. We would be happy to work with the Committee to develop an alternative approach to direct funding for these programs.

Non-Physical Disaster Loans

This $100 million loan fund was abolished in 1981, but was given new life when Congress could not agreee on the authorizations bill for FY 85. In today's climate of 200 billion dollar deficits, we simply cannot afford to spend money we don't have to help businesses hurt by electrical fires in telephone trunk lines, peso devaluation, or not enough snow. Business interruption insurance is available to cover these types of situations; this is one program we can easily sacrifice.

Farm Disaster Loans

Farmers were first made eligible for SBA disaster loans in 1977. At the time the disaster loan level was about $350 million. Over the next three years, the level rose steadily, from about $700 million to $2.1 billion to $2.6 billion. For a short time, farmers were made ineligible for SBA disaster loans but were included again in FY 85. The Farmers Home Administration not only has the expertise to assist farmers with their specialized problems; they have ample funds ($2 billion in 1985) to handle farm disaster loans. Eliminating farmers from the eligibility list for SBA disaster loans will not only eliminate the cost of duplicative service, but will save about $400 million off budget each year.

Management Assistance

The Management Assistance Division at the SBA is a good example of good intentions gone awry. The program has grown over the years into the second largest program area in the agency. In 1984 MA spent $40 million to achieve their impossible mission: to provide counseling and training to small business owners who often won't admit they need help.

There is no question that poor management is a leading cause of business failure or that there is a real need to develop a network of quality assistance for small business owners. Some would question whether providing management assistance is a proper governmental function. More to the point for this discussion is the fact that, despite reorganizations, innovative approaches, and the combined efforts of a number of good people, the MA program area has the reputation of being the worst run, least effective division in the entire agency.

In our recent survey of our members, we found clear evidence to support the suggestions we've made for some time. The delivery system for counseling small business owners obviously has an impact on the effectiveness of any specific program. An important aspect of counseling is trust. If the owner of a business does not trust the counselor, he or she will either not seek help or ignore the advice. We therefore asked our members who they most trust to provide business advice, if cost were no consideration. Two clear choices were given: retired business owners and private consultants. Together they accounted for over 60% of first choice selections and 49% of second or backup selections. College and university business administration teachers were first choice for only 5% of respondents and second choice for 12%.

For the past several years, the MA division has been relying on the Small Business Development Center program as the central focus of their efforts. Clearly from the small business owner's point of view, this is the wrong direction. In FY 85, the SBDC program is slated to cost $28.5 million, over half the MA budget. This is money that could be spent more wisely elsewhere.

Our proposal calls for the elimination of the SBDC program and a thorough review and restructuring of the remaining MA efforts. In keeping with the small business preference, SBA's SCORE and ACE programs merit priority attention rather than the benign neglect they've been receiving for years. From a strictly educational standpoint, I would also like to mention the SBI program as being a low-cost effort which more than pays for itself by providing targeted assistance to business owners and practical, hands-on experience for graduate students, many of whom may someday own or manage businesses.

Finally, Congress' recent authorization for SBA to work with for-profit businesses to provide training and counseling will, we hope, lead to development of a private sector network which can ultimately be virtually self sustaining. We take the lead from our members once again in proposing that a modest fee be structured into the MA efforts, sufficient to offset administrative costs.

If no dramatic improvement can be demonstrated after three years, the management assistance function should be eliminated.

No doubt by now we've left the impression that we want to save an agency that wont do anything. We have just saved the best for last.

Guaranteed Loans

NFIB has long been a supporter of efforts to leverage SBA's resources efficiently. Nowhere is this more vital than in the guaranteed loan arena. While it is certainly true that most small businesses are initially capitalized with personal savings, or funds from friends and relatives, it is also true that small business owners are frequent borrowers who rely heavily on commercial banks. Without access to other means of financing available to large concerns, small business is at the whim of the commercial banking system which is too often averse to making small loans or to providing long-term loans to small firms. This is where the 7(a) guaranteed loan program comes in. GAO, in a 1983 analysis, estimated that "approximately 30 to 40 percent of the dollar amount of banks' long-term financing (6 or more years) to small business may carry an SBA guarantee."[2]

The guaranteed loan program has been filling a void in the financing of small business and should continue to do so. SBA's Administrator, Jim Sanders, has done an admirable job in improving the delivery system, placing more and more responsibility for reviewing, approving, and servicing loans within the lending institutions. We propose further improvements which we believe will safeguard the guaranteed loan program while reducing its cost to the government.

In the private marketplace, a guarantee of repayment costs about 7.5% for loans and about 1.5% for bond guarantees. We propose to increase the SBA guarantee fee to at least 5% of the value of the loan, brining the fee to closer conformity with existing commercial practice. The fee would be capitalized as part of the loan and amortized over the life of the loan. This concept would bring about $100 million per year that could be used to reduce the cost of the program (currently $317 million).

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[2] General Accounting Office, SBA's 7(a) Loan Guarantee Program: An Assessment of Its Role in the Financial Market, RCED-83-96 (April 25, 1983) p. 31.

Further, we suggest that a special fund be created, initial capitalization to come from repayments of past direct loans. The fund would be loaned to the Treasury and the interest--about $100 million--used to fund the remaining cost of the program. This change would further reduce the cost of the guaranteed loan program to less than $117 million.

Procurement Assistance

In 1984, the Procurement Assistance Division spent about $10 million. In fulfilling its primary mission--to ensure small firms get a fair share of the government's procurement dollar--PA has saved the taxpayer about $6 for every dollar it spends. Functioning under a cloud of suspicion and resentment from the procuring agencies they must deal with on a daily basis, SBA's Procurement Center Representatives have done an admirable job in identifying new contracting opportunities for small firms. Rarely do PA personnel get involved with individual businesses; they function behind the scenes, focusing on the big picture, opening up the federal procurement system to new small business contractors, expanding our defense industrial base. There is no doubt that the PA function at the SBA has earned its keep and must be retained.

Finally, Advocacy is small business' top priority at SBA. We all know what Advocacy does, and we know the price tag is small ($5.7 million in 1984). Even so, elimination of the Regional Advocates would save about 1/5 of Advocacy's budget and result in no appreciable weakening of the program.

Even the Administration is loath to take on Advocacy in a full frontal attack. The Administration's plan to abolish the agency also includes provisions to shift to Commerce those programs perceived to be useful, effective, or politically explosive. Advocacy is included in the select group.

Burying Advocacy, or any other SBA program, within the bowels of Commerce will neither enhance its effectiveness nor satisfy small business' need to have an independent voice within the government. The independence of the advocate is critical to the success of the program. This we will not sacrifice.

Conclusion

We offer as a counterproposal to the attempt to eradicate the agency a proposal which radically restructures the SBA but retains essential functions. We respectfully submit that, had the SBA been given the voice in Executive decisionmaking it merits--since it represents the job-generating engine which drives our economy--abolition of the agency would likely not have been a part of the Administration's deficit reduction package. We would therefore like to recommend at this time that the quid pro quo should be elevation of SBA's Administrator to full cabinet status, similar to that enjoyed by the U.S. Trade Representatives.

The CHAIRMAN. John, thank you very much for your testimony. I certainly would go ahead and recommend Jim Sanders be accorded Cabinet status right now. I think there is a question as to whether he is even going to be around as the Small Business Administrator, according to what has been pronounced by the administration. If anybody deserves Cabinet status in terms of running an agency well, it is Jim Sanders.

Mr. SLOAN. We absolutely at NFIB would agree with you.

The CHAIRMAN. I don't need any advice from somebody on a 2-minute learning curve, which is how I would characterize Mr. Stockman, insofar as what to do with the agency. Indeed, Jim Sanders, since the day that he arrived here, has gotten right up to his elbows in the agency. He has cleaned out what needed to be cleaned out, improved what needed to be improved and is still working at that.

I also do not understand how somebody goes ahead—I mean, they are all the same team: Jim Sanders, the President, and Stockman—how you go ahead and get the facts on which to base your recommendations unless you talk with the fellow who is the head of the operation. It is rather weird. As we now know from news accounts, Jim Sanders never knew about it until he was told that the agency was going to be eliminated. That is a question that can be answered later.

I know that Senator Bumpers has a couple questions.

In the study which you commissioned by Tarrance Associates on the SBA, it has been concluded SBA is well known among the NFIB members who generally favorably evaluate it. Would you like to amplify on that conclusion of the report?

Mr. SLOAN. I would be happy to do so. It was an effort we made to do an in-depth interview with some several thousand small business owners, both NFIB members and nonmembers.

Mr. Chairman, this was the question that was proposed to these people: "Now let's talk about the actual experience with the Small Business Administration. Have you ever contacted the Small Business Administration?"

Thirty-four percent said yes. That is a figure that you do not hear when you hear that maybe only 5 percent may be actually made a loan.

If I might, I will amplify with a couple more interesting responses we picked up. That was question 10.

I thought these were two very interesting questions and answers. Question 13 was: "Aside from whether or not you received the desired assistance, was your request handled promptly?"

Yes, 72 percent.

Next question: "Was your request handled courteously?"

Yes, 88 percent.

I think those three questions really indicate that, yes, particularly under this Administrator, we are seeing an effective, efficient job trying to be done to serve those small business people. We, frankly, ourselves were interested to get those kinds of numbers after some of the hearsay evidence we had been getting.

The CHAIRMAN. Senator Bumpers.

Senator BUMPERS. Mr. Sloan, let me say, first of all, that as a friend of NFIB, I am extremely pleased by their position on this.

Let me say one other thing. I do not think I quarrel with anything you have said this morning, even on the farm program. I hesitantly voted to put the farm disaster program in SBA. If we could transfer that whole portfolio over to Farmers Home tomorrow and get it out of SBA, I would vote for it. I am just reluctant at this point, where there is a real farm crisis in this country, to just take SBA out of the farm business category. As I say, if we had the personnel in Farmers Home and we could transfer this over to them, I would do it today. SBA has absolutely no business in the farm loan business of any kind.

Second, let me say that I was just thinking about how OMB has taken such a shotgun approach to this and sort of a scalpel approach. I agree with you, the direct loan program needs to be abolished. Senator Weicker and I are pretty much in accord on that. As I pointed out earlier this morning, we are cutting $600 million out of SBA's operating expenses and the direct loan program, and so on, over the next 3 years. That is tightening up. In my opinion, it is a very responsible position.

I was just checking on some statistics a while ago. I was a trial lawyer before I became a Senator. I would love to take this case to a jury of 12 of our peers and let them decide whether or not the guaranteed loan program should be salvaged.

I can show you a list of 10 companies here that started out with SBIC assistance and probably would not have made it without it. You heard the powerful testimony of two gentlemen, especially Mr. Chase—and was it Mr. Cray—on the first panel this morning, about how they got that SBIC help.

We have not had one single chargeoff in the SBIC program since 1971. The 10 companies I mentioned a moment ago paid $200 million in income taxes in 1983. I don't think in the 10 years I have been here I have heard a more compelling, persuasive argument for the merits of a program than the SBIC.

As I pointed out to Mr. McCormick and Mr. Bennett and others this morning, when you consider not the default ratio but what the loss rate is, and you compare that against the amount of money that the Treasury has taken in from the 80 percent who did not default, it is an overwhelming case. That is not to say I ever applaud a default or a loss of any kind.

Obviously, they do not make these loans to lose. No banker ever lends money in anticipation of having to write it off.

I just want to say that I really compliment NFIB on this, their position. To tell you the truth, I was afraid when this thing first came out that NFIB, which I think is probably the strongest voice in the country for small business—I must say sometimes, I have to say this to you, Mr. Sloan, I was a small businessman. Nobody is more dedicated to the elimination of paperwork for small business. Nobody has fought harder here to bring the Federal bureaucracy under control and regulation. But sometimes when I look at your votes, how you rank Senators—I wish you would check with me before you do that. [Laughter.]

The CHAIRMAN. That is why I think the testimony of the NFIB is all the more compelling on this issue. This is not some Communist organization here. [Laughter.]

Mr. SLOAN. Thank you very much.

The **Chairman**. It is a very conservative group of business people who have gone ahead and devoted their lives within this free enterprise system. I agree, some of the criteria I find a little bit harsh. [Laughter.]

When they indicate their feelings about their dealings with the agency and how they generally do it, I think that is very important. I might add even more so, since I think in this same survey—if just given as a freestanding question—probably a majority would like to see the elimination of the Small Business Administration.

Mr. **Sloan**. That is one of the real hazards. If we just put the freestanding question out there, "Is the President right or wrong?" We do not have the opportunity, as you have had here this morning, to get the details of how it really has had very workable parts.

If I could add one area here that I did not mention a moment ago which concerns us greatly at NFIB, on which we think Mr. Stockman is way off base and look forward to hearing what he has to say to your committee, that is the idea of selling off the portfolio for peanuts. Right now we are hearing maybe 18 or 19 cents on the dollar, raising $1.7 billion. It sounds like a pretty nice figure, but our best estimate is that, if you really worked that portfolio down, would cover the collateral as we heard from that panel, the taxpayer, instead of losing $5 billion, can recover at least $5 billion more. To me, that is one of the weakest parts of the Stockman presentation which we at NFIB just do not understand.

Senator **Bumpers**. Well, nobody could understand that, John. You're dead right. [Laughter.]

To me, here is a man who comes up here with the cloak of fiscal conservatism and tells us that he wants to raise $1.7 billion by selling off a portfolio that is worth $7 billion. That is nonsense. If you were going to abolish SBA this moment, you wouldn't do that.

Mr. **Sloan**. No; and what also bothers me—we agree very much with the chairman; we think we have probably as fine an Administrator at the SBA as we have seen. The reason is that he is an entrepreneur, an independent businessman. He has built a business. He has met payrolls. He understands our problems. He has gone over there and he is running such an efficient organization that the loss rate is down to those figures mentioned by the panel a moment ago. Why not leave it in those capable hands to get the job done and recover that $5 billion?

Senator **Bumpers**. Thank you very much.

The **Chairman**. I thank you very much.

The committee will stand in recess at the call of the Chair.

[Whereupon, at 12:17 p.m., the committee recessed to reconvene at the call of the Chair.]

[Additional material follows:]

II

99TH CONGRESS
1ST SESSION

S. 408

To amend the Small Business Act to provide program levels, salary and expense levels, and authorizations for the Small Business Administration's programs for fiscal years 1986, 1987, and 1988, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 6 (legislative day, JANUARY 21), 1985

Mr. WEICKER (for himself, Mr. BUMPERS, Mr. D'AMATO, Mr. NUNN, Mr. RUDMAN, Mr. SASSER, Mr. KASTEN, Mr. DIXON, and Mr. PRESSLER) introduced the following bill; which was read twice and referred to the Committee on Small Business

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A BILL

To amend the Small Business Act to provide program levels, salary and expense levels, and authorizations for the Small Business Administration's programs for fiscal years 1986, 1987, and 1988, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SMALL BUSINESS ADMINISTRATION PROGRAM LEVELS

SECTION 1. Section 20 of the Small Business Act is amended—

(1) by adding the following new subsections:

"(u) The following program levels are authorized for fiscal year 1986:

"(1) For the programs authorized by section 7(a) of this Act, the Administration is authorized to make $45,000,000 in direct and immediate participation loans; and of such sums, the Administration is authorized to make $20,000,000 in loans as provided in paragraph (10), and $25,000,000 in loans to be made only to disabled veterans, and veterans of the Vietnam era, as defined in section 1841, title 38, United States Code, under the general terms and conditions of title III of Public Law 97-72.

"(2) For the programs authorized by section 7(a) of this Act and section 503 of the Small Business Investment Act of 1958, the Administration is authorized to make $3,180,000,000 in deferred participation loans and guarantees of debentures; and of such sum, the Administration is authorized to make $5,000,000 in loans as provided in paragraph (10), $60,000,000 in loans as provided in paragraph (11), $15,000,000 in loans as provided in paragraph (12), and $450,000,000 in loans as provided in paragraph (13) and guarantees and debentures as provided in section 503.

"(3) For the programs authorized by title III of the Small Business Investment Act of 1958, the Administration is authorized to make $41,000,000 in direct purchases of debentures and preferred securities and to make $250,000,000 in guarantees of debentures.

"(4) For the programs authorized by part B of title IV of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $1,115,000,000.

"(5) For the programs authorized in sections 404 and 405 of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $150,000,000.

"(6) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for the carrying out of the provisions and purposes, including administrative expenses, of sections 7(b)(1) and 7(b)(2) of this Act; and there are authorized to be transferred from the disaster loan revolving funds such sums as may be necessary and appropriate for such administrative expenses.

"(v) There are authorized to be appropriated to the Administration for fiscal year 1986, $555,000,000. Of such sum $333,000,000 shall be available for carrying out the programs referred to in subsection (u), [illegible] through (3); $12,000,000 shall be available [illegible] the purpose [illegible] carrying out the provisions of section 412 of the Small Business Investment Act of 1958; and $210,000,000 shall be available for salaries and expenses of the Administration.".

"(w) The following program levels are authorized for fiscal year 1987:

"(1) For the programs authorized by section 7(a) of this Act, the Administration is authorized to make $47,000,000 in direct and immediate participation loans; and of such sum, the Administration is authorized to make $21,000,000 in loans as provided in paragraph (10), and $26,000,000 in loans to be made only to disabled veterans, and veterans of the Vietnam era, as defined in section 1841, title 38, United States Code, under the general terms and conditions of title III of Public Law 97-72.

"(2) For the programs authorized by section 7(a) of this Act and section 503 of the Small Business Investment Act of 1958, the Administration is authorized to make $3,320,000,000 in deferred participation loans and guarantees of debentures; and of such sum, the Administration is authorized to make $5,000,000 in loans as provided in paragraph (10), $63,000,000 in loans as provided in paragraph (11), $16,000,000 in loans as provided in paragraph (12), and $470,000,000 in loans as provided in paragraph (13) and guarantees of debentures as provided in section 503.

"(3) For the programs authorized by title III of the Small Business Investment Act of 1958, the Administration is authorized to make $43,000,000 in direct purchases of debentures and preferred securities and to make $261,000,000 in guarantees of debentures.

"(4) For the programs authorized by part B of title IV of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $1,164,000,000.

"(5) For the programs authorized in sections 404 and 405 of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $157,000,000.

"(6) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for the carrying out of the provisions and purposes, including administrative expenses, of sections 7(b)(1) and 7(b)(2) of this Act; and there are authorized to be transferred from the disaster loan revolving funds such sums as may be necessary and appropriate for such administrative expenses.

"(x) There are authorized to be appropriated to the Administration for fiscal year 1987, $597,300,000. Of such sum $368,000,000 shall be available for carrying out the programs referred to in subsection (w), paragraphs (1) through (3); $15,500,000 shall be available for the purpose of carrying out the provisions of section 412 of the Small Business Investment Act of 1958; and $213,800,000 shall be available for salaries and expenses of the Administration.".

"(y) The following program levels are authorized for fiscal year 1988:

"(1) For the programs authorized in section 7(a) of this Act, the Administration is authorized to make $49,000,000 in direct and immediate participation loans; and of such sum, the Administration is authorized to make $22,000,000 in loans as provided in paragraph (10), and $27,000,000 in loans to be made only to disabled veterans, and veterans of the Vietnam era, as defined in section 1841, title 38, United States Code, under the general terms and conditions of title III of Public Law 97-72.

"(2) For the programs authorized by section 7(a) of this Act and section 503 of the Small Business Investment Act of 1958, the Administration is authorized to make $3,458,000,000 in deferred participation loans and guarantees of debentures; and of such sum, the

Administration is authorized to make $6,000,000 in loans as provided in paragraph (10), $65,000,000 in loans as provided in paragraph (11), $16,000,000 in loans as provided in paragraph (12), and $489,000,000 in loans as provided in paragraph (13) and guarantees of debentures as provided in section 503.

"(3) For the programs authorized by title III of the Small Business Investment Act of 1958, the Administration is authorized to make $45,000,000 in direct purchases of debentures and preferred securities and to make $272,000,000 in guarantees of debentures.

"(4) For the programs authorized by part B of title IV of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $1,213,000,000.

"(5) For the programs authorized in sections 404 and 405 of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $163,000,000.

"(6) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for the carrying out of the provisions and purposes, including administrative expenses, of section 7(b)(1) and 7(b)(2) of this Act; and there are authorized to be transferred from the disaster loan revolving funds such sums as may be necessary and appropriate for such administrative expenses.

"(z) There are authorized to be appropriated to the Administration for fiscal year 1988, $619,800,000. Of such sum $387,000,000 shall be available for carrying out the programs referred to in subsection (y), paragraphs (1) through (3); $14,500,000 shall be available for the purpose of carrying out the provisions of section 412 of the Small Business Investment Act of 1958; and $218,300,000 shall be available for salaries and expenses of the Administration."; and

(2) by striking from subsection (t) "and for each of such years" and inserting "for fiscal year 1985".

DISASTER LENDING REFORMS

SEC. 2. Section 7(b) of the Small Business Act is amended by striking paragraphs (3) and (4).

S. 408, A BILL TO AUTHORIZE AND PROVIDE PROGRAM LEVELS FOR THE SMALL BUSINESS ADMINISTRATION FOR FISCAL YEARS 1986, 1987, AND 1988

THURSDAY, FEBRUARY 28, 1985

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, at 9:35 a.m., in room SR 428A, Russell Senate Office Building, Hon. Lowell Weicker, Jr. (chairman of the committee) presiding.

Present: Senators Weicker, Boschwitz, Pressler, Kasten, Bumpers, Sasser, Levin, Baucus, and Nunn.

Staff present: Robert J. Dotchin, staff director; R. Michael Haynes, chief counsel; John W. Ball III, minority chief counsel; and Dorothy C. Olson, hearing clerk.

The CHAIRMAN. The committee will come to order. We will reconvene.

As the matter of our first business of the committee, we will have a videotape by the President of the United States made on September 21, 1983. Immediately following that, we will hear from the first witness before the committee, Mr. David Stockman.

[A videotape speech by President Reagan was shown. A transcript of the videotape follows:]

TRANSCRIPT OF PRESIDENT REAGAN'S STATEMENT TO THE MEMBERS OF THE NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

SEPTEMBER 21, 1983

Good evening to all of you S.B.I.C. principals, small business entrepreneurs, Members of the Congress, and current and former SBA officials gathered tonight to honor the 25th Anniversary of the National Association of Small Business Investment Companies.

S.B.I.C.'s and MESBIC's (MEZ-bics) have been pioneers of private sector/Government efforts to expand the availability of venture capital for small businesses. Your product and service breakthroughs, the jobs created and retained, the economic gains, and yes, the additional taxes collected over the last quarter century from your program's success have real meaning for all of us.

You've proven that public/private partnerships can do things that Government alone cannot accomplish. The ingenuity, perseverance, and profit motive of the private sector works remarkably well with Government encouragement. This is where you fit in. And it's not just money. Even more than the impressive financial assistance you've provided is the development of a resevoir of human capital. The S.B.I.C. managers have strengthened the ability of the small business sector to innovate, compete, and grow.

The sole role of the Minority Enterprise Small Business Investment Companies, which we also recognize tonight, is to assist small businesses whose ability to compete is hampered by racial or ethnic considerations. This mission ties in directly with my goal of ensuring that all Americans share in the opportunities of our free enterprise system.

A special congratulations to the 12 small business men and women being recognized in tonight's ceremonies: Your truly outstanding business and personal achievements include the development of photo equipment used in our space program, the building of a highly successful tool and die business by a couple who fled Castro's Cuba with only the clothes on their backs, and a community-based emergency response system which permits the handicapped and infirmed to live at home rather than in hospitals and nursing homes. Other accomplishments in your select group include the founding of a leading magazine for Black women, several impressive successes in the highly competitive and innovative computer, word processing, printing and communication fields, and a rapidly growing manufacturer of low cost housing. Your success is based on filling the needs of others, and doing it efficiently and at a reasonable price. I hope other Americans profit from your example.

Many thanks to your leadership -- Bob Zicarelli, Walter Stults, Patric Jones, JoAnn Price -- and to former President Pat Jacobs. Finally, Jim Sanders, keep up the good work at SBA so that the years to come will be even better for SBICs and the small businesses they serve.

Thank you all and God bless you.

The **Chairman**. Having heard from the President of the United States, we will now hear from our first witness, the Honorable David Stockman, Director of the Office of Management and Budget.

Mr. Stockman.

STATEMENT OF HON. DAVID A. STOCKMAN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. **Stockman**. Thank you, Mr. Chairman.

I might just start by saying that we at the White House have come to enjoy watching old movies of the President. This experience this morning is not entirely new or surprising.

But I do appreciate this chance to appear before you and regret that I was not here last week at the scheduled time. But while I was temporarily out of the office last week, I read that the committee was interested in hearing facts and not graffiti. We have prepared a paper that is chock-a-block with compelling facts and rigorous analysis that has been available to the committee for about a week. I hope you had a chance to analyze it. I am sure that you do not necessarily agree, but I think we have taken a new and thorough look as to where SBA credits actually go and what connection they may have, if any at all, to public policy objectives that we would like to serve.

For my presentation this morning, Mr. Chairman and members of the committee, I would like to simply summarize the basic findings and conclusions which we believe support the case for terminating all SBA credit programs in light of the dire fiscal circumstances which now prevail. And then, of course, since you have had a chance to go through this testimony for a week now, I am sure you have questions, or I am sure you disagree, and we will have a chance to go through those issues.

First, let me begin, from the macroeconomic perspective, SBA does not enlarge the national pool of business credit resources. It just reallocates funds away from more creditworthy to less creditworthy firms. That in an aggregate sense reduces overall national economic efficiency, economic growth, and job creation.

Now, in this regard, the mechanical counts of jobs per SBA loan confuse the particular with the aggregate. Yes, it is, of course, true that every SBA loan funds a business project which involves a countable number of jobs. If it did not, the program would amount to pure fraud because the money would have to be going somewhere, even into someone's mattress. Clearly it finances projects in which jobs are involved. But, at the same time, every SBA loan uses available lendable funds that would have gone to someone else or another firm in the absence of the risk reducing Government guarantee. This alternative use of the credit would have also financed business projects with an attributable number of jobs. To deny this substitution effect, that we are merely substituting one loan for another and changing the risk faced by the lender, that we are merely substituting one project for another, one job for another, is to imply that the Nation's banks and financial institutions are waterlogged with idle funds that are released for productive investment and job creation only by SBA guarantees.

Now, the truth is more nearly the opposite. Our deregulated financial institutions are engaged in the fiercest kind of competition to place credits and all available funds it loaned out. As a result of this, the case for SBA lending cannot rest on macroeconomic claims of job creation or business activity stimulation but, instead, it must lie in specific public policy objectives, in the justification for reordering the marketplace allocation of credit in order to promote specific objectives that serve purposes that the marketplace on its own would otherwise not serve.

I would like to suggest to the committee this morning that the lengthy statement that I submitted to you last week attempts to describe and assess those public policy objectives that SBA must serve if it is to be justified. It attempts to do this in two basic ways: No. 1, by analyzing the flow of SBA credits to determine who gets them and what apparent objective is served by their receipt of subsidized SBA credits; and, No. 2, by analyzing the various claims that are made from time to time as to the policy objectives that SBA lending serves, such as promoting new startups, helping small business compete with big business, or stimulating high tech investment and growth and job creation, to determine if these objectives actually are served, if this actually happens and to what degree.

Table 1 on pages 7 and 8, and table 2 on page 10 of my testimony summarize our findings on the first question, where do SBA credits flow? I think these data, and you have had a chance to look them over, support three conclusions. First, most SBA lending, 60 percent of it, goes to helping a small fraction of small businesses in retail, wholesale and service industries compete with other small businesses which must pay the bank rate for the financing they need in the same sectors and markets. Second, there is no shortage of firms or new starts or services or lack of competition to the public in these trades which account for 60 percent of SBA lending, because there is an overwhelming number of firms, a fierce amount of competition, and no empirical evidence that has ever been adduced, to my knowledge, that somehow the market is being underserved in these areas.

The third conclusion is that no unique public policy objectives are served by extending subsidized credits to 1 percent of the firms that supply these basic economic services.

I think if you just look at the results that we have on page 7, for instance, and you see that the single largest category of SBA lending in 1984 was bars, restaurants, liquor stores, travel, lodging, and entertainment establishments, some 2,700 loans, some $529 million of SBA advances, 16 percent of total SBA lending during the year went to that sector. If you look at the fourth column in my table, you see that there is a prodigious amount of firms trying to provide the services to the American people, competing vigorously, nearly 350,000 of them, according to the Commerce Department data, and that in 1984, SBA loans only reached eight-tenths of 1 percent of the firms.

Now, I do not think there is any compelling reason that I can see in looking at this data to suggest that new businesses would not get started in the bar business or the restaurant business or the bowling alley business or the dance studio business without SBA loans.

Clearly they do. The American people are not being underserved in this area. It is all small business so the concentration ratios, as you can see in the final column, are so small that these industries are dominated by small firms.

Similarly, if you look at the second category that we have displayed on this table, doctors, lawyers and other professionals such as accountants and engineers and so forth, nearly 1,500 SBA loans went out in 1984 to that category involving some $228 million in SBA loans, about 7 percent of the total. I cannot see what public purpose is served by supplying the subsidized credits to less than 1 percent of those who have operations in this area.

Similarly, the bottom column on this table consists of car dealers and automotive services and sales firms or establishments of one type or another. As you can see, in 1984, some 1,700 loans went out involving $278 million or about 8 percent of SBA lending. But this agglomeration of various types of small business dominated local and competitive firms involved some 374,000 establishments nationwide. The SBA lending swooped in and helped one-half of 1 percent compete with all the rest, or at least those in their local market area with subsidized credits.

Similarly, if you look at the various categories on the second page of our table that summarizes the 60 percent share of SBA lending, coin operated laundries and dry cleaners, beauty shops and barber shops, sports recreation, toys, and hobby sales outlets, real estate agencies, advertising agencies, furniture and furnishing sales, food stores, and on down the line, nearly 6,500 loans were made in this sector, nearly $1 billion of SBA guarantees, 28 percent of all SBA lending.

But the point is, according to the Commerce Department data, there are nearly 2.3 million firms competing in these areas. The SBA lending reaches less than one-third of 1 percent. Most of them who need credit have to go to the bank and pay the rate, which is probably at least prime plus 1 or 2 percent. There is ample and long lasting competition and the concentration ratios are low, and it is very difficult to see just what we are accomplishing with that flow of credit.

On the second table I will refer to just briefly on page 10, we have picked out about 20 particular categories in order to demonstrate that the pattern we have displayed for 1984 is not an aberration. This table actually summarizes or accumulates SBA lending over 6 years, from 1978 to 1984. This is the total loans over the 6-year period. As you can see, the physicians, dentists, and the medical professions have received $736 million, nearly three-quarters of $1 billion in SBA subsidized credits. I do not know why. Country clubs, tennis clubs, golf courses, bowling alleys, pool halls, sporting goods stores, and so forth have received $358 million. These are worthwhile services. The American people want them. Thousands of firms supply the needs and demands of the public, but why do they need subsidized credits? I cannot find the answer in looking at the data.

The third bank which consists of the basic entertainment and restaurant industry that we talked about before, on a 6-year basis received $2.9 billion worth of subsidized SBA credits. I think most people who have represented local areas in the country, as I did in the congressional district in Michigan, know that the firms in these areas compete vigorously. They come and go, but it is hard for me to see why we need to make an effort to subsidize a very few of them. And so on down the line in this table, nearly $5.5 billion over 6 years in subsidized SBA credit flows are shown

To summarize my point here, since 60 percent of SBA credit is going to the small business sector of the economy that is vigorously competitive, is going to firms that cannot get credit elsewhere in the regular channels of banking and finance, I have to conclude inadvertently that what we are basically doing is helping a very small fraction of the firms in this robust sector of the economy to compete unfairly. Let me stress that. They compete unfairly with the 99 percent of firms who, when they need credit to finance the cars on their lot, if they are a car dealer, or finance an improvement if they are running a restaurant, have to go to the bank and pay the full rate. These firms then find that they face competition for customers, find that they may be losing market share, find that prices are lower than they would like to have them, or profits or rates of return are disappointing because they have to compete in an already tough market with somebody who has a subsidized loan.

Those are the remarks I would like to make this morning on the first question.

Let me turn to the second issue which is raised in our presentation, and that is simply to try to assess the claims that are made for the SBA credit and lending programs from time to time to see whether or not we can find any evidence for that in the great accumulation of data, both as to SBA lending and the general structure of our industry. One claim that is often made is that new business starts would be insufficient in the small business area. It is too hard to get started, there are obstacles to entry, credit is hard to find, and so therefore SBA performs an important role in spawning new firms.

On page 12 of our testimony, we have taken a look at about 16 basic industries. These are basic small business lines from auto dealers all the way through, insurance, advertising, and so forth, the same kinds of firms that we have demonstrated receive SBA credits. What we did was take SBA and Commerce data that is available on the rate of new starts, new firms that rise or are generated over time in these industries. Looking at line 17 on table 3, in 1976 there were about 668,000 firms or establishments serving the needs of consumers in these sectors. Over the next 6 years, and that is the second column, nearly 300,000 new firms or establishments appeared that were not there in 1976. That is the new starts. That is the new competition. That is the new service. In other words, in these sectors, over a 6-year period, there was a 44 percent increase relative to the starting base in new firms and establishments out there providing services and competing. A lot of the other firms disappeared during that period, and that is shown in the next column. And if you add the new starts and the disappearances, nearly 488,000 or 73 percent of the firms and establishments that were there in 1976 had either gone or new ones had replaced them.

So what this shows you is a profile of vigorous competition, enormous turnover, and a huge spawning of constant new starts and firms in these sectors.

Now, what was the SBA role over these 6 years? In the final two columns, we have demonstrated here that in 1984 as a typical year, SBA made about 3,700 loans or loans to about six-tenths of 1 percent of the firms in these industries. Now, the point is if 300,000 firms can start up on their own over a 6-year period, a couple of thousand SBA loans per year basically do not change the picture. What this demonstrates is that the marketplace itself and the incentives people have to start businesses, to become entrepreneurs, to leave the restaurant where they were a maitre d' and start their own operation are so compelling, and it happened preponderately without SBA help. I do not think we have to worry about the lack of adequate startups or lack of adequate competition or lack of ability to get into these lines and services without the SBA lending programs.

The second issue that is often raised is addressed on page 14, and that is the claim that the SBA lending programs are needed especially to help generate what we all want, and that is as much expansion and creativity and technological innovation as possible in our sunrise industries, the high tech firms we count on for our economic growth and jobs in the future.

What we have done here on page 14 is list 14 major obvious high-tech sunrise industry firms that we all talk about, ranging from semiconductors and related electronic components, to surgical and medical instruments, and computer programming and software. Again we said what happened over the last 6 years in terms of new jobs, new firms and the role SBA played.

In 1976, there were about 50,000 firms. This is such a prodigiously generating expanding area of the economy that in the next 6 years, 27,000 new firms or establishments appeared where there had only been 49,000 in the base year. A 54-percent increase in the number of new firms or establishments.

Similarly, in the base year of 1976, there were 1,782,000 jobs, and in the next 6 years nearly 1 million new jobs were generated in these 14 sunrise industries of our national economy.

Now, the question is, What role does SBA play in this kind of prodigious outpouring of new firms, new opportunities, new jobs and technologies? In 1984, 600 loans were made to this sector of the economy amounting to about $120 million or less than eight-tenths of 1 percent of SBA lending. But, again, if you think about 1 million jobs, if you think about 25,000 firms, several hundred loans from the SBA a year may have helped a few, but basically most of them started, the jobs appeared because somebody had an idea that they were willing to stand behind, and some bank, some venture capital firm, some private individual investor was willing to put the money up in order to get this firm off the ground. There is no evidence in this table that these basic sunrise industries rely in any significant degree on SBA lending.

Now, the third issue that is often raised is that SBA help——

Senator BOSCHWITZ. May I ask you those 602 loans occurred in 1 year or 6 years?

Mr. STOCKMAN. Those occurred in 1 year, 1984.

What I am saying is on an annual basis, 500, 600 loans are made. These patterns change from year to year, but I am saying also that over a 6-year period, something like 27,000 new firms or establishments appear.

Also I am saying that only a small fraction of SBA's total lending during the year 1984, eight-tenths of 1 percent of the firms that existed in 1984, actually received SBA credits.

Now, the same kind of picture, in my view, holds for the issue of helping small businesses to compete with big business and we have addressed this on page 17. We have selected 19 of the well-known and major, heavily concentrated industries where the 4 major firms in the industry dominated 56 to 90 percent of total market share. The four-firm ratio is what is normally used in looking at market concentration and competition. Of course, in all of these industries, there are a lot of small firms that compete for the scraps and along the margin, and the question that we tried to raise in this particular part of the analysis was, does SBA move into these heavily concentrated industries where big business dominates, but where there are small firms that could use some credit to help the small businesses maintain some kind of toeholds. The answer is I do not see much evidence for it, even though there is something like 200 billion dollars' worth of sales in these industries in 1984 and 5,000 establishments competing. There were 32 SBA loans made to these industries and many of them did not get any SBA loans at all.

So I think, since you are talking about the heartland of concentrated industries where big business dominates, there is not much evidence to suggest that SBA plays an important role in that dimension of the argument.

That gets us to the bottom line which I have tried to summarize on page 27 of my testimony. I would just like to highlight it for the committee in concluding my presentation this morning.

Our basic view is that SBA conducts a $3 to $4 billion annual lending program which indiscriminately sprays a faint mist of subsidized credit into the weakest and most prosaic nooks and crannies of the Nation's $4 trillion economy. In the process, it serves almost no rigorously defined public policy purpose objective.

Most SBA credits go to small business dominated wholesale, retail, and service markets already abundantly populated with vital, profitable small business firms that pay their own way in credit markets and their share of taxes to support subsidized competitors.

SBA credit volumes are inconsequential in most markets, reaching one-half of 1 percent of firms at best.

The trade and service sectors in which SBA lending is concentrated have long been prodigious natural incubators of new firms and entrepreneurial innovation. Bureaucratic lending is self-evidently not needed to foster new business formation. The attractions of profitmaking and independent entrepreneurship are far more powerful and determinative.

SBA has played no significant role in financing sunrise industries and the booming small business, high-tech sectors on the cutting edge of U.S. economic growth.

SBA devotes insignificant resources to helping small businesses compete with big businesses. Mostly it helps a tiny fraction of weak small businesses that are not credit worthy compete with unsubsidized firms in naturally competitive healthy markets.

Since SBA credit programs are so costly to the budget, inconsequential in magnitude, and unnecessary to a thriving small business sector, the vague generalized feeling of helping, and I know that is the basic reason behind the SBA programs, held by its advocates, is a luxury we can no longer afford. Determined efforts to improve tax and regulatory laws and the fiscal and financial environment which affect 100 percent of small businesses would be far more beneficial than the current indiscriminate 1 percent of market lending programs that costs the budget money and exacerbates the fiscal problem.

SBA's essential irrelevance to most business sectors in which it participates cannot be cured with substantial increases in credit resources. This would logically lead to socialized credit markets, bureaucratic stifling of small business entrepreneurship and reduced national economy, efficiency, investment and job growth.

Overall SBA credit programs have no defensible public policy mission. Ironically, they inadvertently harm real, specific unsubsidized small firms in the name of promoting the generic cause of small business. The present fiscal crisis provides an opportunity to look through the myths and dispense with a major Federal activity that serves no compelling national need.

Now, I know there is some argument with this committee as to whether the SBA's guaranteed and other credit programs cost money. I have addressed that on page 20 of my testimony. I am sure we will get to it in the questioning.

But I simply point out that the SBA lending programs involve a 10- to 20-year credit cycle and we do not know how much we lose until we actually get to the end of that 20-year period.

So the best measure of what the ultimate loss rate is on SBA guarantees is to look at the oldest loans we have in the portfolio that are readily available for analysis. We have done this and as you can see, for 1971 to 1973, we have already experienced a loss rate of 10 percent. There is about $60 million more in loans under liquidation and we are going to lose some of those that are outstanding.

So I think it is fair to say as a minimum, based on the most mature credits that are out there and the most complete credit cycle that we have, that the ultimate loss rate is somewhere in the range of 10 to 12 percent. On a $3 billion annual lending program, that would be $300 to $400 million in direct losses to the Treasury and the taxpayers.

When we add to that the several hundred million dollars that are needed to engage in support of this huge lending network of offices, it is clear that the main line SBA lending programs, to say nothing about the direct loans that the committee apparently agrees we should now eliminate, cost about half a billion dollars a year at minimum. This is in addition to the origination costs of the Federal Financing Banks, which have to be borrowed in the first instance.

So I conclude, after looking at all of this evidence, that this is a drain on the budget that we can no longer afford. While there is a generalized sense of helping small business behind the entire apparatus of SBA programs, if you look at where it goes, you cannot find a compelling reason to keep it going.

If you ask, does it serve many of the objectives that are commonly claimed, the answer is it does not seem to be the case and, therefore, we have made the recommendation to this committee and the Congress that we have.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Stockman.

[The prepared statement of Mr. Stockman follows:]

TESTIMONY OF THE

HONORABLE DAVID A. STOCKMAN

DIRECTOR,

OFFICE OF MANAGEMENT AND BUDGET

I. OVERVIEW AND KEY POINTS

- This presentation is devoted exclusively to a single question: should SBA remain in the banking, credit allocation and subsidy business or should these activities be terminated as proposed in the President's FY 1986 Budget?

- Other SBA functions -- small business advocacy, procurement assistance, various small business and minority set-aside programs, technical assistance and aid to minority firms -- are proposed for consolidation in an independent "Administration for Enterprise Development and Opportunity" in the Commerce Department. The Administration believes that these programs will produce useful results at very low budget cost.

- The Administration's proposal to terminate all credit assistance programs -- direct, guaranteed and FFB-financed -- is based on the following general framework of analysis:

    - As a matter of pure economics, SBA does not enlarge the national pool of business credit resources -- it just re-allocates funds away from more credit-worthy firms to less credit-worthy firms. By definition, therefore, it reduces marketplace efficiency and national investment, job creation and economic growth by substituting political and bureaucratic judgments of profitability and risk for market judgments. This macro-economic loss is the "opportunity cost" of the public policy objectives served by SBA.

    - Nevertheless, some public policy objectives require the sacrifice of marketplace efficiency. Selective override of pure market efficiency where public interest or social policy gains are judged to outweigh economic losses -- e.g. steel import restraints, farm subsidies and means-tested transfer payments -- is an accepted feature of modern American government. Unfortunately, neither stated SBA policies nor empirical analysis of SBA's lending patterns provide any evidence that subsidized SBA credit assistance serves any focussed or rigorously defined public policy purpose at all.

    - In fact, the overwhelming bulk of SBA credit resources (60%) flow to a tiny fraction of non-credit worthy firms in mainstream service, retail and wholesale sectors. These markets are abundantly populated with efficient, profitable, credit-worthy small businesses which satisfy a plethora of consumer needs at competitive prices while paying the going-bank rate for loans.

- The actual pattern of SBA general business lending* suggests, therefore, that rather than serving a public good these programs may inflict unfair private economic harm: the 99% of unsubsidized small businesses (i.e. non-SBA borrowers) in the sectors where SBA lending is concentrated undoubtedly face downward pressure on market shares, prices, profits and return on investment owing to the artificial presence of government fostered and subsidized competitors. Moreover, since the formation rate of new small businesses in these mainstream trade and service sectors is so prodigious, the unfair harm to existing, unsubsidized small businesses cannot possibly be outweighed by any thus far undocumented gains in new business formations or survival rates among the few thousand firms aided by SBA credit programs each year.

- The nation's taxpayers are now being tapped at the historic limit -- 19% of GNP. Yet spending remains at 24-25% of GNP and thereby threatens continued non-inflationary economic recovery. In these circumstances, programs which both undermine market-based economic growth and have largely counter-productive public policy effects (unfair competition) should be the first spending commitments pared from our overloaded Federal budget. The SBA credit assistance programs clearly fall into this category.

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* This assertion pertains to the $3.3 billion of total SBA lending of which 88% was allocated to general business as opposed to EOL, Veterans and handicapped programs in 1984.

II. SBA LENDING PROFILE: WHO GETS HELPED OR HURT

- In 1984, two-thirds of SBA'S development company and guaranteed loans* and 60% of its lending volume flowed to the small business-dominated retail, wholesale and service sectors of the U.S. economy. The 39 business lines and SBA lending to firms within them displayed in Table I (page 7) have several relevant characteristics:

  - Each category contains a super abundance of mostly small business firms ranging from about 1,000 firms in the case of "dance studios" to 360,000 firms in category number 31 -- "Lawn and garden, candy, stationary and other sales establishments."

  - With only a few exceptions, the threat of market domination by large firms is non-existent: 86 percent of the sectors for which information is available have 8-firm concentration ratios of 20% or less. The bulk of subsidized SBA loans do not help small business compete against big business.

  - Instead, they help an infinitesimal fraction of small businesses in each sector compete with other small businesses in the same trade. On average, SBA supplied subsidized credit to less than 1% of the firms in each of the 39 categories. Most of the car dealers, restaurants, bowling alleys, barber shops, insurance agencies and apparel stores which compete with SBA borrowers paid the going bank rate to meet their credit needs. Unless the entire subsidy value of loan guarantees is captured by the banks, which is not the case, these credit subsidies unfairly harm existing small business competitors.

  - No case has ever been made that these 39 business categories are characterized by significant market imperfections, such as too few firms; too little competition; too little innovation; entry barriers to new firm start-up; or inadequate responsiveness to consumer demand and welfare. SBA lending does not improve the structure of markets -- it just unbalances the competitive playing field on which thousands of tax-paying small businessmen have staked their entire economic wealth.

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* Throughout this analysis, "SBA lending" encompasses the general business, economic opportunity, handicapped, and energy guaranteed loans, and development company loans funded at an aggregate level of $3.9 billion in 1985.

- Table 1 shows that SBA channels credit resources and resulting economic activity randomly. While all 39 categories involve legitimate and valuable economic services as established by the time-tested evidence of the marketplace -- no case has ever been made that the Federal government can improve national economic prosperity by fostering more or bigger car washes, bars, accounting firms, real estate agencies or hardware stores. The entrepreneurial spirit is alive and well in all of these work-a-day sectors and will satisfy consumer demands and contribute to national economic growth without taxpayer aid.

No Case For Subsidized Credit: Bars, Restaurants, Liquor Stores, Travel, Lodging, Entertainment

- Over one-half billion dollars or 16% of SBA lending flowed to this group in 1984. $370 million of this amount flowed to restaurants, bars and liquor and tobacco stores alone.

- Out of nearly 343,000 firms engaged in all business lines in this group, only 2,700 or 0.8% were SBA borrowers. Not a shred of evidence suggests that this sector is systematically under served by private banks. Indeed, there never has been nor ever will be a shortage of firms, services or opportunities for determined individuals to start or expand businesses in these markets. Random SBA assistance can only hurt as many firms as it helps.

- The nearly $80 million in loans advanced to dance studios, bowling alleys and pool halls, golf courses, country clubs and tennis clubs, amusement parks and other recreational enterprises is especially questionable. SBA aided about 400 firms in these business lines out of a total of 65,000 firms. The thriving marketplace in leisure time activities can self-evidently more than meet the needs of both consumers and producers without taxpayer assistance.

No Justification: Doctors, Lawyers and Other Professionals

- $228 million or 7% of SBA lending flowed to a variety of independent office professionals in 1984. Between 1978 and 1984 nearly three quarters of a billion dollars in loans were advanced to doctors, dentists and other medical professionals alone (see Table 2).

- No conceivable public policy purpose is served by these subsidized credits. Average U.S. physician income is now $106,300/year, a level not plausibly related to economic need -- especially in light of heavy Federal subsidies for medical education. Moreover, physician and dental facilities and equipment are fully mortgagable -- obviating any serious issue of credit availability. And, if anything, the nation is oversupplied with practicing physicians and dentists, creating upward pressures on medical costs and putting SBA capacity expanding loans at cross-purposes with other major Federal initiatives to restrain the growth of medical capacity.

- SBA loans go to physicians, chiropractors, lawyers, accountants and engineers because a small fraction manage to get turned down by banks and meet the loose test of small business eligibility. But these loans meet no test of valid public policy purpose at all.

No Need For Subsidized Credit: Car Dealers and Automotive Services/Sales

- There are nearly 79,000 new and used car dealers and boat dealers in the nation according to Commerce Department data. The 290 firms or 0.37% of this total which received SBA credit in 1984 prove SBA credit programs are not needed. Every dealer must finance floor plans and inventory -- a major expense of doing business in this trade. Apparently upwards of 78,000 obtained private market credit without any SBA help at all.

- Nor does SBA have much to do with starting new dealerships in an industry that has been an incubator of new businesses since the beginning of the Auto Age. Between 1976 and 1982, 4,668 used car dealerships were started nationwide. In this context, SBA lending to several dozen used car dealers per year is inconsequential. Entrepreneurial energy not bureaucratic loans is the essential ingredient in this and almost all comparable small business lines.

- Likewise, the nations 4,000 car washes, 90,000 body and repair shops and 200,000 miscellaneous auto supply and services businesses come and go, succeed and fail, almost entirely without SBA ministrations. As in most other small business markets, SBA serves less than 0.5% of the firms. The remaining 99% make do without SBA aid and often in spite of SBA subsidized competition.

Mainstreet Merchants: 99.8% Pay Their own Way -- And Federal Taxes Too

- There are more than 2.3 million establishments in other mainstreet business lines -- retail and wholesale, personal and business services and finance and real estate. While SBA advanced $900 million in loans to these firms in 1984, the 6,500 SBA borrowers represented only 0.28% of total "mainstreet" firms. If accurate figures could be compiled, total credit use for inventory, equipment, facilities and working capital by these firms would amount to hundreds of billions each year. SBA is largely irrelevant in these markets, too.
    - 252 coin-operated laundries and dry-cleaners got SBA credit but about 37,000 paid their own way. Since demand for laundry services is not terribly elastic, some tax-paying dry-cleaners got squeezed by their tax-using competitors.
    - 123 jewelry, watch and fur sales outlets got SBA credit -- but nearly 40,000 competitor firms financed their own inventories. It is difficult to imagine how this inherent inequity is balanced by any public policy good; or why nearly $116 million in SBA loans advanced over the past 6 years to jewelry, watch and fur dealers -- many of which have defaulted -- should have been made at all.
    - Never has a case been made that the nation is under supplied with real estate and insurance agencies, or that an enterprising salesman wishing to launch his or her own firm faces significant barriers to start-up. But in 1984, SBA made $26 million in loans to 164 insurance and real estate agencies. The 260,000 remaining firms paid their own way as well as the taxes necessary to support SBA's $509 million in FY 1984 outlays.
- In short, the marketplace supports and the private banking system finances several million mainstreet merchants -- grocery stores, hardware stores, beauty and barber shops, advertising agencies, detective firms, furniture stores, lawn and garden shops etc. Competition is vigorous; small establishments dominate the markets; a never-ending stream of new entrants make their appearance without subsidized credit (see Table 3); and every conceivable need of the American consuming public is eventually fully satisfied. In this context, SBA's few thousand loans make only one consistent difference: millions of taxpaying small businesses face unneeded and uneconomic competition from bureaucratic clients who can't compete profitably, or at all, on a level playing field.

- TABLE 1 -

1984 SBA LENDING TO RETAIL, WHOLESALE AND SERVICE INDUSTRY FIRMS

Business Line/Sector	SBA Lending			Market Sector Characteristics		
	# of Loans	Loan Amount (thousands)	Share of SBA Total*	# of Firms	SBA Loan Ratio **	Market Concentration (Top 8 Share)
Bars, Restaurants, Liquor Stores, Travel, Lodging, Entertainment						
1) Restaurants	1,794	$328,769	10.0%	163,091	1.1%	7.3%
2) Bars	112	14,857	0.5%	40,406	0.3%	0.8%
3) Liquor, tobacco stores & sales	160	26,709	0.8%	25,456	0.6%	19.5%
4) Hotels, motels, tourists	242	80,233	2.4%	48,256	0.5%	14.0%
5) Dance studios	13	1,862	0.1%	962	1.4%	NA
6) Bowling alleys & pool halls	76	20,651	0.6%	11,460	0.7%	11.4%
7) Golf courses, country clubs, tennis clubs	45	11,174	0.3%	13,688	0.3%	NA
8) Other recreation/entertainment	262	44,747	1.4%	39,426	0.7%	12.6%
9) Subtotal	2,704	529,002	16.0%	342,745	0.8%	NA
Doctors, Lawyers, Professionals						
10) Physicians, dentists	835	126,682	3.8%	23,628	3.5%	NA
11) Chiropractors, osteopaths	124	10,950	0.3%	2,416	5.1%	NA
12) Other health services	240	35,974	1.1%	47,840	0.5%	NA
13) Lawyers	76	11,241	0.3%	20,874	0.4%	1.3%
14) Accountants	115	14,312	0.4%	14,305	0.8%	NA
15) Engineers, other professionals	163	28,532	0.9%	99,054	0.2%	8.7%
16) Subtotal	1,553	227,691	6.9%	208,117	0.7%	NA
Car Dealers & Automotive Services/Sales						
17) New car dealers	223	60,481	1.8%	44,542	0.5%	1.7%
18) Used car dealers	40	4,854	0.1%	15,690	0.3%	1.2%
19) Boat dealers	27	5,333	0.2%	18,511	0.1%	3.2%
20) Car washes	130	25,257	0.8%	4,357	3.0%	4.0%
21) Repair & body shops	593	66,848	2.0%	90,173	0.7%	1.9%
22) Other auto supplies, services, sales	767	115,559	3.5%	200,751	0.4%	16.3%
23) Subtotal	1,780	278,332	8.4%	374,024	0.5%	NA

	SBA Lending			Market Sector Characteristics		
Business Line/Sector	# of Loans	Loan Amount	Share of SBA Total*	# of Firms	SBA Loan Ratio **	Market Concentration (Top 8 Share)
Mainstreet Merchants: Personal & Consumer Services						
24) Coin-operated laundries/drycleaners	252	28,906	0.9%	36,969	0.7%	8.9%
25) Beauty shops/barber shops	126	11,285	0.3%	19,122	0.7%	4.3%
26) Photographic studios, funeral homes, other services	374	48,990	1.5%	124,153	0.3%	10.7%
27) Subtotal	752	89,181	2.7%	180,244	0.4%	NA
Mainstreet Merchants: Discretionary Goods						
28) Sports, recreation, toys, hobby goods sales	275	36,382	1.1%	73,352	0.4%	20.4%
29) Jewelry, watches, furs	123	16,294	0.5%	39,563	0.3%	22.0%
30) Radio, TV, music stores	164	18,277	0.6%	121,181	0.1%	14.6%
31) Lawn & garden, candy, stationary, other sales	786	86,486	2.6%	360,558	0.2%	16.0%
32) Subtotal	1,348	157,439	4.8%	594,654	0.2%	NA
Mainstreet Merchants: Insurance, Banking, Real Estate & Business Services						
33) Stock & commodity brokers	7	1,511	.0%	19,149	.0%	NA
34) Real estate agents	75	12,209	0.4%	209,782	.0%	NA
35) Insurance agents	89	13,706	0.4%	52,042	0.2%	NA
36) Advertising agencies	44	6,695	0.2%	26,368	0.2%	13.8%
37) Detective agencies & security services	15	1,833	0.1%	5,006	0.3%	NA
38) Other banking & business services	902	130,852	4.0%	331,863	0.3%	NA
39) Subtotal	1,132	166,806	5.1%	644,210	0.2%	NA
Mainstreet Merchants: Basic Goods						
40) Furniture & furnishings sales	458	72,597	2.2%	154,863	0.3%	16.2%
41) Hardward goods sales	527	86,796	2.6%	119,848	0.4%	16.5%
42) Clothing & apparel	503	57,672	1.7%	187,221	0.3%	20.5%
43) Food stores	1,189	187,807	5.7%	192,557	0.6%	21.1%
44) Department stores	105	15,923	0.5%	82,411	0.1%	49.6%
45) Other retail/wholesale basic goods	490	79,228	2.4%	153,527	0.3%	24.2%
46) Subtotal	3,272	500,023	15.2%	890,427	0.4%	NA
Total						
47) 39 wholesale/retail/service lines	12,541	1,948,474	59.1%	3,234,421	0.4%	NA
48) Total, all market sectors	19,041	3,298,749	100.0%	4,723,718	0.4%	NA

* Share of total 1984 SBA loan guarantees and business development company loans.

** SBA loans divided by total number of firms in business line or sector.

III. SBA LENDING PROFILE: NO SHORTAGE OF NEW STARTS AND PLENTY OF QUESTIONS

- Table 2 displays cumulative 1978-84 lending totals for 20 of the business lines displayed in Table 1. These data make clear that the 1984 lending patterns are not atypical. Over the 6-year period:
  - restaurants were advanced nearly $1.8 billion in SBA credits;
  - bars, liquor stores and tobacco stores got nearly $300 million;
  - country clubs, tennis and golf clubs, pool halls and bowling alleys received $233 million in SBA credits;
  - gas stations, car washes and auto dealers got more than $1 billion;
  - doctors, dentists and other medical practitioners received nearly $750 million.
- All of these business lines clearly provide valid and worthy economic services to the American people. But it is not clear at all what worthy public policy objective is served by advancing subsidized loans to less than 1% of the firms in these already competitive, dynamic and small business dominated markets.

- TABLE 2 -

SBA LENDING TOTAL FOR 1978-84 IN SELECTIVE SMALL BUSINESS MARKETS

	Market Sector	Total Loans, 1978-84	Total Loan Volume, 1978-84 ($ in millions)
1)	Physicians	1,906	$257
2)	Dentists	3,175	270
3)	Chiropractors, other medical professionals	2,313	209
	o Subtotal	(7,394)	($736)
4)	Country clubs, tennis, golf courses	417	119
5)	Bowling alley and pool halls	473	114
6)	Sporting goods and bicycle shops	1,477	125
	o Subtotal	(2,367)	($358)
7)	Restaurants	12,738	1,811
8)	Bars	997	108
9)	Liquor and tobacco stores	1,405	183
10)	Hotels, motels, tourists	1,459	411
11)	Other amusement, recreation	1,953	340
	o Subtotal	(18,552)	($2,853)
12)	Car washes	803	129
13)	New and used car dealers	3,532	710
14)	Gasoline stations	2,254	216
	o Subtotal	(6,589)	($1,055)
15)	Lawyers	567	53
16)	Accountants	1,842	214
17)	Beauty and barber shops	994	53
18)	Jewelry, watches, furs	1,096	116
19)	Stock and commodity brokers	41	6
20)	Gift shops	1,106	82
	o Grand Total	40,548	$5,525

New Small Business Starts: SBA's Role is De Minimus

- While from a national interest perspective there is no rhyme or reason to the pattern of SBA credit allocations among specific industry sectors, it might nevertheless be argued that SBA performs an important general catalyst role in generating new firms and fresh entrepeneurial blood in the mainstream retail, wholesale and service markets where its lending is concentrated. An analysis of the 1976-82 pattern of new firm births and total industry turn-over, however, suggests that this function is ably performed in the market-place and that the SBA lending presence is inconsequential.
  - In the six years between 1976 and 1982, almost 300,000 new firms appeared in the 16 business lines shown in Table 3. This represented nearly 45% of firms existent in the 1976 base year. When new firms are combined with firms that disappeared during the 6 year period, the gross turnover rate is a staggering 73%. Thus, the nearly 500,000 firms which either started or folded under the natural exigencies of the marketplace during this brief period totally dwarf the 4,000 or so per year which receive SBA credit assistance. The small business marketplace is such a prodigious generator of start-ups, successes, failures and liquidations that anecdotal claims about SBA's role in promoting competition and new competitors should not be taken seriously.
  - For example, nearly 35,000 new auto body and repair establishments emerged between 1976 and 1982 -- or 45% of the base year total. SBA's 600 per year loan level could support only a small fraction of these start-ups -- even if all loans went to new entrants which is clearly not the case.
  - Likewise, over 100,000 new real estate, insurance and advertising agencies emerged during the six year period -- 43% of the 1976 base. SBA's 200 loans per year have virtually nothing to do with the powerful ebb and flow of firms in these business lines.
  - Finally, although restaurants are consistently SBA's largest lending category, the 85,000 new firm start-ups between 1976-1982 prove that marketplace opportunities for profit and independent entrepeneurship rather than subsidized credit drives the staggering outpouring of new firms in this business line. Not more than 2% of these new starts could have received SBA assistance even if half of SBA restaurant loans went to new firms -- an assumption unsupported by the data. Moreover, given the 105% gross turnover rate in this heavy SBA lending sector, only one conclusion can be drawn: current SBA lending levels have virtually no impact on new business formation rates, but run a significant risk of incurring losses for no valid public purpose.

- TABLE 3 -

NEW BUSINESS FORMATION RATES AND GROSS TURNOVER RATES IN SELECTIVE WHOLESALE/RETAIL/SERVICE MARKETS

	Business Line	Base # of Firms (1976)	1976-82 New Starts		1976-82 Gross Turnover*		1984 SBA Loans	
			Number	% of Base	Number	% of Base	Number	% of Base
1)	Auto dealers	56,330	10,149	18%	26,392	47%	263	0.5%
2)	Boat dealers	18,152	3,449	19%	6,539	36%	27	0.1%
3)	Car washes	3,884	2,058	53%	3,642	94%	130	3.3%
4)	Auto repair & body shops	77,190	34,723	45%	56,462	73%	593	0.8%
5)	Restaurants	137,753	84,956	62%	144,573	105%	1,794	1.3%
6)	Hotels, motels, tourism	47,929	15,654	33%	30,980	65%	242	0.5%
7)	Bowling allies & pool halls	11,695	2,276	19%	4,786	41%	76	0.6%
8)	Dance studios	452	692	153%	873	193%	13	2.9%
9)	Golf courses, tennis & country clubs	11,368	4,048	36%	5,775	51%	45	0.4%
10)	Coin operated laundries, dry cleaners	36,341	13,016	36%	25,403	70%	252	0.7%
11)	Beauty & barber shops	9,669	12,457	129%	15,459	160%	126	1.3%
12)	Stock & commodity brokers	15,332	7,710	50%	11,602	76%	7	0.0%
13)	Real estate agencies	174,905	73,078	42%	111,728	64%	75	0.0%
14)	Insurance agencies	41,075	18,608	45%	26,248	64%	89	0.2%
15)	Advertising agencies	22,967	9,299	40%	15,196	66%	44	0.2%
16)	Detective agencies & security services	3,567	2,476	69%	3,512	98%	15	0.4%
17)	Grand Total	668,609	294,649	44%	488,720	73%	3,791	0.6%

* Combined number of firms which started or disappeared during 1976-1982 in each business line.

IV. SBA LENDING PROFILE: SECTORS WHERE SBA CREDITS DON'T FLOW

Sunrise Industries Grow on Their Own

- It is frequently claimed that SBA spurs the emergence and growth of new firms on the dynamically-expanding technological frontiers of the American economy. Table 4 proves that this is hardly the case: each of the 14 manufacturing sectors displayed in the table is characterized by rapid emergence of new firms, massive gains in employment and huge increases in annual output. In aggregate, employment rose by nearly 1 million jobs or 52% between 1976 and 1982 -- compared to 12% job growth in the overall U.S. economy. Likewise, the number of firms increased by 27,000 or 54% during the same period. Yet on an annual basis, SBA credits reach only 600 or 0.8% of these archtypical high tech firms.
    - In the case of semi-conductors -- more than 500 new "Silicon Valley" type firms generated 84,000 new jobs over 1976-82. Yet current SBA lending reaches just 13 firms annually. Private banking system credits clearly meet the overwhelming bulk of financing requirements in this sector.
    - Nearly 5,000 new firms emerged over 1976-1982 in electronic components and parts, process control, and engineering, scientific and electronic measuring instrument industries, and more than 253,000 new jobs were created. However, less than 150 or 0.7% of the current firms in these industries receive SBA credits. Most have obtained financing from venture capital and private bank sources in sufficient volumes to support unparalled growth of output and jobs.
    - The number of firms in computer programming and software, data processing and other computer services nearly doubled between 1976 and 1982 -- rising by 11,500. Job growth exceeded 250,000 or 100%. By contrast, annual SBA credits reach about 250 firms annually or 1% of these rapidly expanding industries. Private financing satisfies a preponderant share of the funding requirements.
- These data do not imply that SBA should target more assistance to sunrise industries. They simply prove that the marketplace miracles of small business and high tech growth have almost nothing to do with the bureaucratic myths about SBA lending.

- TABLE 4 -

SUNRISE INDUSTRY GROWTH AND SBA LENDING

Industry	Base # of Firms (1976)	1976-82 Firm Increase		Base # of Jobs (1976)	1976-82 Job Increase		SBA Lending ($ in millions)		
		Number	Percent		Number	Percent	Loans	Amount	Ratio*
1) Electronic computing equipment	1,262	+1,121	+89%	312,315	+134,731	+43%	24	$7.3	1.0%
2) Industrial controls	1,038	+190	+18%	85,716	+16,508	+19%	9	1.8	0.7%
3) Telephone apparatus	470	+143	+30%	160,303	+15,124	+9%	6	3.4	1.0%
4) Semiconductors & related	1,362	+572	+42%	129,917	+84,080	+65%	13	3.0	0.7%
5) Electronic components ..	4,042	+1,021	+25%	289,588	+120,086	+41%	63	14.3	1.2%
6) Engineering & scientific instruments	1,400	+166	+12%	75,440	+36,723	+49%	12	3,8	0.8%
7) Process control instruments	1,076	+770	+72%	78,823	+24,887	+32%	18	4.3	1.0%
8) Electronical measuring instruments	946	+401	+42%	55,447	+39,315	+71%	12	3.3	0.9%
9) Electronic parts & equipment	9,607	+2,552	+27%	95,594	+32,432	+34%	42	9.3	0.4%
10) Surgical & medical instruments	1,130	+342	+30%	56,239	+55,534	+99%	12	3.0	0.8%
11) Commercial machines & equipment	15,402	+7,814	+51%	201,998	+106,648	+53%	143	27.2	0.6%
12) Computer programming & software	3,431	+5,555	+162%	58,436	+95,804	+164%	148	23.1	1.6%
13) Data processing services	5,951	+2,549	+43%	154,728	+107,739	+70%	42	6.4	0.5%
14) Computer related services	2,467	+3,425	+140%	28,272	+48,943	+173%	58	10.3	1.0%
15) Total	49,584	+26,647	+54%	1,782,816	+918,554	+52%	602	120.7	0.8%

* 1984 SBA loans as percent of 1982 firms in industry.

Concentrated Sunset Industries: The Myth That SBA Helps Small Business Compete With Big Business

- SBA mostly advances subsidized credits to small businesses to compete with other unsubsidized small businesses. In the basic manufacturing and machinery industries dominated by a few large firms, SBA lending is virtually non-existent.

- Table 5 displays 19 concentrated U.S. industries as measured by four-firm concentration ratios in excess of 56%. These industries accounted for 11% of total industrial output in 1977. Although each is heavily dominated by a handful of large firms, they do contain a large number of smaller, specialized businesses.

- In 1984, SBA credits reached only 32 firms in this entire group. SBA lending volume totalled $8.9 million or .27% of its total lending volume. Self-evidently, these token lending volumes are inconsequential relative to the financing requirements of either the industry giants or the smaller firms which successfully compete with them.

- Again, these data do not suggest that greater amounts of SBA credits should be targeted to "Big Business" dominated industries. They simply demonstrate that a program designed to bureaucratically disburse funds by the numbers -- $100,000 per loan/ $500,000 total loans outstanding -- cannot make a difference in sectors where large and small businesses actually compete.

Import Impacted Industries: SBA Reaches One Percent of the Market Like Everywhere Else

- When SBA credits advanced to construction, trucking and other domestic transportation industries are added to the 60% of total SBA lending which flows to the retail/ wholesale and service sectors displayed in Table 1, it appears that 75-80% of SBA lending falls outside of the internationally traded sector of the U.S. economy. Moreover, as previously demonstrated, there is no market imperfection theory which explains or justifies the flow of subsidized credit to these purely domestic sectors.

- In light of the high dollar and the severe financial pressures being currently experienced by internationally traded sectors, it might be possible for industrial policy advocates to justify subsidized lending to small firms impacted by these macro-economic forces.

- However, as shown in Table 6, SBA is not a significant lender in 12 industries heavily impacted by imports, as measured by import penetration ratios in excess of 20%. Again, SBA credits reach about 68 firms or .2 percent of the total in these sectors. The $15.7 million in SBA credits advanced in 1984 comprise just .48 percent of SBA total lending volume.

- Since even a substantial correction of the dollar exchange rate and U.S. trade balance is not likely to alter the long-term trend toward contraction and disinvestment in these industries, it is not clear that even a massive subsidized lending program would be appropriate or make any difference. But to the extent that SBA credit programs contribute to the budget deficit and the resulting international monetary and trade distortions now besieging the traded goods sector of the U.S. economy, it is evident that the macro-economic harm far outweighs the relative pittance of subsidized SBA lending which reaches the most adversely impacted sectors of the U.S. economy.

- TABLE 5 -

CONCENTRATED SUNSET INDUSTRIES
($ in millions)

	Industry	Market Concentration Top 4 Share	Total Firms	Total Industry Sales 1984 Dollars	SBA Lending Loans	SBA Lending Amount
1)	Cereal breakfast foods	89%	99	$3,984	0	$0.0
2)	Malt beverages	64%	115	$10,612	1	0.1
3)	Woven carpets & rugs	67%	206	$75	1	0.3
4)	Tire cord & fabric	80%	43	$1,616	0	0.0
5)	Greeting card publishing	77%	350	$1,710	2	0.6
6)	Alkalies & chlorine	66%	134	$2,640	0	0.0
7)	Industrial gases	65%	585	$1,970	2	1.0
8)	Organic fibers, noncellulosic	78%	142	$1,600	2	0.4
9)	Rolling mill machine[illegible]	62%	127	$93	2	0.4
10)	Turbines & turbine generator sets	86%	195	$4,354	0	0.0
11)	Nonferrous forgings	77%	67	$729	1	0.5
12)	Automotive stampings	65%	552	$15,534	7	2.6
13)	Aluminum sheet, plate, foil	72%	104	$9,524	0	0.0
14)	Flat glass	90%	287	$2,515	5	0.6
15)	Tires & inner tubes	70%	216	$14,309	1	0.5
16)	Steel investment foundries	56%	86	$651	0	0.0
17)	Office machines	60%	404	$4,338	1	0.1
18)	Electric lamps	90%	491	$2,633	2	0.2
19)	Motor vehicles & car bodies	93%	793	$122,046	5	1.6
	20) Total		4,996	$200,932	32	$8.9

- TABLE 6 -

IMPORT IMPACTED INDUSTRIES
($ in thousands)

	Market Sector	1984 Import Penetration Ratio	Total Establishments	SBA Lending	
				Loans	Amount
1)	Motorcycles & parts	67.3%	20,743	4	622
2)	TVs & radios	59.9%	975	2	650
3)	Silver & plated flatware	27.6%	397	--	--
4)	Primary zinc & smelting & refining	60.1%	55	--	--
5)	Footwear & excluding rubber	50.4%	286	2	699
6)	Luggage & personal leather goods	53.2%	2,488	16	2,420
7)	Textile machinery	52.9%	745	8	2,432
8)	Rubber & plastic footwear	37.1%	80	4	1,034
9)	Pulp mills	47.4%	193	--	--
10)	Metal cutting machine tools	34.2%	2,062	23	5,746
11)	Medicinal & botanicle products	39.3%	475	6	1,832
12)	Cold rolled steel sheet & strip	20.6%	345	3	243
13)	Total		28,844	68	15,628

V. THE BUDGET COSTS OF SBA LENDING PROGRAMS

The Budget Cost of SBA Lending Programs

- SBA loans, loan guarantees and development company loans confer substantial economic values on recipients:
  - 7-year $100,000 direct loans at 6% interest have a discounted subsidy value of $15,462 just compared to Treasury financing costs. But qualifying, high risk SBA borrowers cannot get money at the Treasury rate in financial markets. Even assuming a minimum 500 basis point spread for extra risk, a generous assumption, the total discounted subsidy value for below market interest and high risk is $27,079 on a $100,000 loan.
  - In the case of a $100,000, 10-year loan guarantee, the discounted subsidy value for the 90% of extra risk shifted to the Treasury is $10,097 if the risk-spread is 300 basis points and $15,905 if the risk-spread is 500 basis points. Similar calculations would apply to FFB-financed development company loans.
- The notion that SBA loan guarantees don't cost anything is both theoretically and empirically wrong. The Federal government cannot confer economic value without ultimately absorbing commensurate budget cost. High risk -- the qualifying criterion for SBA credits -- inherently creates high defaults and a cash loss drain on the Federal government.
- In this regard the alleged low default rates frequently reported for SBA guaranteed lending are fundamentally misleading because they compare apples and oranges. The current reported loss rate for general business guaranteed loans, for example, is 6.0%. But this ratio is based on comparing total disbursements-to-date with final net charge-offs to-date.
  - Every SBA loan guarantee faces up to a 7-20 year credit cycle involving initial disbursement, potential borrower default, SBA purchase of defaulted loans from banks, SBA direct collection or work-out efforts and final loan closure or charge-off.
  - But the reported 6.0% default rate-to-date ratio captures 100% of the initial disbursement in the denominator but only a part of the ultimate credit cycle loss experienced in the numerator. Thus, the ratio at any point in time is incomplete, misleading and understates the true ultimate loss rate.
  - This is especially true since nearly half of the SBA 7(a) portfolio was dispersed in the last five years when the average guarantee term (loss exposure) is double that or nearly 11 years. Moreover, as a matter of policy and practice SBA exercises a substantial degree of forbearance in working out and charging off bad loans once they are purchased from participating banks -- a factor which stretches the ultimate credit cycle even longer.
  - A more accurate picture of true SBA guarantee losses can be achieved by dividing SBA credits into maturity cohorts. The older cohorts reflect a more complete credit cycle and therefore a closer approximation of the true long-run budget exposure for any given level of current SBA credit guarantee issuance.
  - Table 7 provides a ready measure of ultimate loss exposure. The "maximum" potential loss exposure is bracketed by the amount and percent not paid in full to date; the "minimum" exposure by the amount charged-off to date; and the "intermediate" exposure by the amount purchased to date and now in SBA managed work-out. In this latter case -- some but not all of the purchase amount may be eventually charged off, depending upon the circumstances of each case and SBA forbearance policies.

- TABLE 7 -

SBA LOAN GUARANTEE EXPOSURE AND LOSS RATES BY MATURITY COHORT
(millions)

Loan Cohorts	Loans Disbursed	Maximum Exposure: Loan Balances Outstanding		Intermediate Exposure: Defaulted Loans Purchased		Minimum Exposure: Loans Charged-off	
		Amount	%	Amount	%	Amount	%
Maturity Cohorts							
1) 1971-1974	4,317	$598	13.9%	$787	18.2%	$429	9.9%
2) 1975-1977	4,814	$995	20.7%	$778	16.2%	$383	8.0%
3) 1978-1981	9,680	$4,606	47.6%	$2,103	21.7%	$590	6.1%
4) 1982-1985	5,010	$4,044	80.7%	$234	4.7%	$29	0.6%
Total, 1971-1985							
5) All loan guarantees	23,821	$10,243	43.0%	$3,902	16.4%	$1,431	6.0%

- The 1971-1974 cohort gives the most complete picture because the credit cycle is 11-14 years old. On this cohort, the charged-off amount is already $429 million or 10% and could rise to a maximum of 14% given $58 million in additional loans now in liquidation status and $111 million remaining in service.

- Later cohorts are in lesser stages of maturity, but it is already apparent that the $9.7 billion 1978-81 cohort will likely experience an ultimate loss rate of greater than 10%, since nearly 22% of initial disbursements have been repurchased by SBA and more than $4.6 billion remain in outstanding balances. Since the ultimate loss to purchase rate for the more mature 1971-74 cohort is already nearing 60% -- a 12% ultimate loss rate would be unsurprising for the 1978-81 loans.

- Finally, it is evident that the large $8.7 billion outstanding balance on the two most recent cohorts severely distorts the loss-rate-to-date measure shown in line (5). Since 16% of the loans have already defaulted at the bank level and have been purchased by SBA, and since nearly 60% of the original disbursement is still in service, the 4.2% charge-off rate experienced to date on 1978-1985 experience is far below the ultimate outcome.

- In general, it must be concluded that each $3 billion annual installment of SBA loan guarantees will cost the Treasury $300-400 million in losses excluding the interest cost of carrying repurchased loans not in current payment status -- of which there are more than $1 billion worth at the present time.

SBA Outlays

- The ultimate costs of SBA's lending programs involve an extended credit cycle as displayed above. However, the build-up of the SBA portfolio over the last decade to a total of $8.6 billion in guaranteed loans outstanding and $8.3 billion in direct loans, as well as its extensive network of servicing and administrative offices, has generated an annual cash outlay for total SBA activities now exceeding $1 billion. This reflects the net cash flow effect of administrative outlays, direct loan originations vs. repayments, FFB loan originations vs. repayments, purchases of defaulted guarantees vs. collections on the default portfolio and the net cash flow of the disaster fund.

- Since SBA is by stated policy a money losing bank, these huge net outlays are not a transitory phenomenon. Since 1978, total net SBA outlays have exceeded $10.5 billion -- an outcome which adds directly to the consolidated Federal deficit and Treasury borrowing requirements:

Total SBA Outlays

	Billions
1978	$2.8
1979	1.7
1980	2.0
1981	2.0
1982	0.8
1983	0.7
1984	0.5
Total, 1978-84 ...	$10.5

- However, even these figures do not fully reflect the budget deficit reduction that can be achieved by terminating the SBA lending programs as recommended by the Administration. Since SBA outlays reflect net flows of both BLIF, Disaster Fund and FFB new loan originations and outstanding loan repayments, termination of new lending activities will reduce the outflow of new cash while maintaining the inflow of old loan repayments. Moreover, by selling off old loans the repayment flow can be accelerated into the 1986-88 budget period when substantial deficit reduction is imperative. The table below indicates the detailed basis for Administration estimates that termination of SBA credit programs can reduce the deficit by $5.3 billion over the next three years.

BUDGET OUTLAY SAVINGS FROM ADMINISTRATION SBA PROPOSAL

	Outlay Savings 1986	1987 (millions)	1988	Total
1) Phase-down and disband SBA credit servicing offices	23	175	222	420
2) Terminate new direct and guaranteed business loan obligations	215	238	406	859
3) Terminate development company & other FFB loan obligations	306	562	573	1,441
4) Terminate disaster loan programs	259	321	179	759
5) Sell existing $9.8 billion loan asset portfolio over 4 years	671	610	549	1,830
6) Other	-7	-2	2	-7
7) Total	1,467	1,904	1,931	5,302

VI. SBA LOAN ASSET SALES ESTIMATES

- The Administration's plan to terminate SBA credit programs includes a proposal to sell SBA's existing portfolio of loan assets over a four year period beginning in 1986. On the basis of very conservative assumptions regarding market discounts on these assets, we have estimated four year proceeds of nearly $2 billion -- inflows which would directly reduce the Federal deficit.

- It has been subsequently claimed that retention and servicing of these SBA loan assets under existing SBA policies would result in a far higher repayment stream than estimated for the direct asset sales approach contained in the budget. This argument fails to reckon, however, with several crucial considerations:

  - The Administration's $2 billion figure is a minimum conservative estimate of likely market discount rates on SBA loan assets due to below market interest rates, mixed quality of loan assets now in the portfolio and the inherent high risk nature of SBA credits. If market bidders are more optimistic about the quality and risk of at least some SBA loan assets, the actual discounts will be lower and the sales proceeds higher than current estimates.

  - The likely market discount on SBA assets acutally available for sale is not directly comparable to the average overall repayment rates on SBA credits in recent years. This is due in part to the fact that $4.2 billion or 43% percent of the $9.8 billion in assets which could be sold over the next four years are the worst of the lot: SBA loans already in delinquent or liquidation status or estimated to default over the sales period. It is assumed that these loan assets are nearly worthless and would sell at near 100% discounts, if at all. This brings down the average return of the current overall SBA portfolio available for sale.

  - Comparison of ultimate SBA repayment ratios with assumed market discounts under the proposed sales program is also misleading and incorrect because it ignores the time value of money and the interest subsidy carrying cost of below-market SBA loans. All SBA loan assets must be financed with Treasury borrowing both to originate direct loans and FFB loans and to purchase defaulted guarantees. These Treasury borrowings must be serviced over the term of the SBA acquired asset. When assets are sold prior to maturity the interest cost of financing them is eliminated. The same is true for below-market direct loans: asset sales will preclude the need for Treasury financing of the difference between its cost of money and the SBA lending rate.

  - Table 8 below provides a detailed spread of the types and categories of SBA loan assets proposed for sale, along with salient loan characteristics including average interest rates, maturities, and loss experience on similar assets. The asset yield columns provide a range of possible market values based on asset characteristics. The 1986 budget receipt estimates are based on the "low" assumptions for each category. If market valuations and bids turn out closer to the "medium" or "high" assumptions up to an additional $1 billion could be realized.

  - The table makes clear that the expected sales price for SBA loan assets varies enormously by category. In the case of $3 billion in disaster loan assets carrying an average 4% interest rate, there would be a deep market discount due to the below market rate alone. This would be compounded by the inherent risk of repayment in this category. We have therefore estimated sales yields between 28-48 percent of face value.

  - By contrast, development company loans bearing 12.3 percent average interest rates and in current payment status are estimated to yield 50-70 percent of face value.

TABLE 8
ASSET SALES ASSUMPTIONS
($ in millions)

Type of Loan	Portfolio Amount Sold	Average Interest Rate	Average Maturity (Years)	Loss Rate	Asset Yield (%) Low	Asset Yield (%) Medium	Asset Yield (%) High	Receipts Low	Receipts Medium	Receipts High
Direct Loans: Current Payment Status										
1) Business	330	9%	6	15%	40%	50%	60%	$119	$148	$178
2) Economic Opportunity .	60	9%	5	37%	10	20	30	4	9	13
3) Handicapped	75	3%	9	15%	20	30	40	14	21	28
4) MESBIC	281	8.2%	6	N/A	20	30	40	56	84	112
5) Disaster	3,017	4%	7	4%	28	38	48	848	1,144	1,446
6) Development Company ..	196	6%	10	10%	50	60	70	98	117	137
7) Subtotal	$3,959	4.9%	N/A	N/A	29	38	48	$1,139	$1,523	$1,914
FFB Originated Loans										
8) Small Business Investment Cos.	$679	11.5%	6	N/A	40	50	60	272	339	407
9) 503 Development Cos..	967	12.3%	19	10%	50	60	70	484	580	677
10) Subtotal	1,646	12%	N/A	N/A	46	56	66	$756	$919	$1,084
Repurchased Loan Guarantee Assets: Current Payment Status										
11) Business	$180	12%	6	40%	10	20	30	6	10	18
12) Economic Opportunity .	5	11%	4	82%	1	1	3	-	--	--
13) Guaranteed Loans 1/ ..	594	13.5%	6	60%	1	1	3	15	17	28
14) Future Repurchases 2/.	1,230	13.5%	6	60%	1	1	3	12	14	37
15) Other	25	N/A	N/A	N/A	1	1	3	--	--	--
16) Subtotal	$2,034	13.4%	N/A	N/A	2	2	4	$33	$41	$83
Other SBA Loan Assets										
17) Delinquent Loans	615	N/A	N/A	N/A	3	3	5	17	17	31
18) Loans in Liquidation .	1,538	13.6%	5	N/A	1	1	3	15	15	46
19) Subtotal	$2,153	13.6%	N/A	N/A	1.6	1.6	3.6	$32	$32	$77
Grand Total SBA Loan Portfolio										
21) Total Portfolio	$9,792	6.4%	7	N/A	20	26	32	1,956	2,515	3,158

1/ Guaranteed loans currently delinquent or in liquidation that would be repurchased and sold.
2/ Current guaranteed loans expected to default and be repurchased in 1986-1989.

VII. SBA LENDING PROGRAMS: SUMMARY AND CONCLUSIONS

- SBA conducts a $3-4 billion annual lending program which indiscriminately sprays a faint mist of subsidized credit into the weakest and most prosaic nooks and crannies of the nation's $4 trillion economy. In the process, it serves almost no rigorously defined public policy purpose:
  - Most SBA credits go to small business dominated wholesale/retail and service markets already abundantly populated with vital, profitable small business firms that pay their own way in credit markets -- and their share of taxes to support subsidized competitors.
  - SBA credit volumes are inconsequential in most markets -- reaching one-half to one percent of firms at best.
  - The trade and service sectors in which SBA lending is concentrated have long been prodigious natural incubators of new firms and entrepreneurial innovation. Bureaucratic lending is self-evidently not needed to foster new business formation -- the attractions of profit-making and independent entrepreneurship are far more powerful and determinative.
  - SBA has played no significant role in financing sunrise industries and the booming small business, high tech sectors on the cutting edge of U.S. economic growth.
  - SBA devotes insignificant resources to helping small businesses compete with big businesses. Mostly it helps a tiny fraction of weak small businesses compete with unsubsidized firms in naturally competitive, healthy markets.
  - Since SBA credit programs are so costly to the budget, inconsequential in magnitude, and unnecessary to a thriving small business sector, the vague, generalized feeling of "helping" held by its advocates is a luxury we can no longer afford. Determined efforts to improve tax and regulatory laws and the fiscal and financial environments which affect 100% of small businesses would be far more beneficial than the current indiscriminate 1%-of-market lending programs.
  - SBA's essential irrelevance to most business sectors in which it participates cannot be cured with substantial increases in credit resources. This would logically lead to socialized credit markets, bureaucratic stifling of small business entrepreneurship and reduced national economic efficiency, investment and job growth.
  - Overall SBA credit programs have no defensible public policy mission. Ironically, they inadvertently harm real, specific, unsubsidized small firms in the name of promoting the generic cause of small business. The present fiscal crisis provides an opportunity to look through the myths and dispense with a major Federal activity that serves no compelling national need.

LOAN APPROVALS (FY 81 THRU FY 85)
AS OF DECEMBER 31, 1984

		-TOTAL LOANS APPROVED--		---------- PREVIOUS BORROWER --------			
		NUMBER	AMOUNT	NUMBER	AMOUNT	# %	$ %
FY 81	BUS	24,557	2,734,511,079	3,659	460,089,679	14.9	16.8
	DIS	43,946	1,514,649,294	5,270	349,857,189	12.0	23.1
82	BUS	15,448	1,779,056,473	2,228	267,279,550	14.4	15.0
	DIS	9,853	169,389,099	204	14,023,835	2.1	8.3
83	BUS	19,240	2,563,878,855	3,156	462,397,966	16.4	18.0
	DIS	12,238	203,100,871	65	3,238,900	.5	1.6
84	BUS	21,280	2,994,457,028	2,775	432,004,693	13.0	14.4
	DIS	14,127	310,008,350	3	247,700	.0	.1
85	BUS	4,468	619,202,435	646	98,641,416	14.5	15.9
	DIS	2,916	91,147,200	0	0	.0	.0

Source: SBA February 1985

7(A) GUARANTEE LOAN APPROVALS

FISCAL YEAR	PREVIOUS NON-PREVIOUS BORROWER IND	NO. LOANS	GROSS AMT	SBA SHARE
81	NO	18776	2,659,094,358.91	2,323,199,099.47
81	YES	3546 16%	559,832,139.39	493,750,692.75
81		22322	3,253,916,500.20	2,903,999,727.22
82	NO	5696	937,779,992.95	717,701,992.59
82	YES	6296 53	905,991,838.99	779,734,104.04
82		11992	1,743,761,829.74	1,497,435,996.63
83	NO	1520	290,334,023.37	206,593,864.17
83	YES	5145 77%	910,179,691.94	699,377,764.36
83		6665	1,050,512,715.31	905,971,629.53

Yes => Previous Borrower under 7A Program

Source: SBA Summer 1983

The CHAIRMAN. Now, of course, and this is the only matter which I intend to touch upon in a philosophical sense—the rest of my questioning will deal with facts that you are presenting both to this committee, to the Congress and to the American people. But of course your conclusions and your evaluations are at contradiction to the statements of the President, as we saw in the film, where the President makes the statement referring to the small business investment companies and minority small business investment companies, that—

> Your product and service breakthroughs, the jobs created and retained, the economic gains, and yes, the additional taxes collected over the last quarter century from your program's success have real meaning for all of us.
>
> You've proven that public/private partnerships can do things that Government alone cannot accomplish. The ingenuity, perserverance, and profit motive of the private sector works remarkably well with Government encouragement. This is where you fit in. And it's not just money. Even more than the impressive financial assistance you've provided is the development of a resevoir of human capital. The S.B.I.C. managers have strengthened the ability of the small business sector to innovate, compete, and grow.
>
> The sole role of the Minority Enterprise Small Business Investment Companies, which we also recognize tonight, it to assist small businesses whose ability to compete is hampered by racial or ethnic considerations. This mission ties in directly with my goal of ensuring that all Americans share in the opportunties of our free enterprise system.

I appreciate the amusement that old Presidential films cause in the White House, but what about the rest of the United States that is not in the White House? Who do we believe as far as evaluations and conclusions—the President of the United States or the Director of the Budget?

Mr. STOCKMAN. Let us get this one right up front. You are confronted with two pieces of evidence in your committee this morning. One is a film made from a script that the President read prepared by the SBA. The second is a policy proposal that was recommended by the President in his 1986 budget after a vigorous debate before him and after he heard the case at length on both sides of the question, the case for eliminating the lending programs from me, and as all of you know, this is no secret, the case for maintaining the lending programs from the current SBA Administrator, who had written the script for last fall's film. The SBA issue was the very last issue he decided in this budget, and, therefore, it came at the end of the difficult process that he had, of trying to get a $230 billion deficit under control. After weighing all of the issues, he concluded that all things equal, everything said and considered, that what we must do now is eliminate the lending programs, and maintain the small business advocacy, minority and procurement assistance programs, but eliminate the big lending programs because we cannot afford them and they are not justified under the circumstances.

I have provided the reasons here today that motivated my recommendation to him, that led to the decision that he made, and I think these are persuasive reasons, even if you do not agree.

The CHAIRMAN. What I do not agree with, and what I intend to devote my time to today, are your facts. They are either wrong, or they are incomplete, or they are misleading.

In that sense, I think both Congress and the President are not served very well. The American public also.

So let us start going down them one by one, rather than going ahead and speculating or philosophizing.

You issued a booklet to the Congress which came up in the Republican Caucus which is a background from the President, going to the Congress, and going to the media. These facts were spoon-fed to the Wall Street Journal, having seen their editorial this morning. Let us talk about what you state are facts or how you have presented them.

No. 1, on page 11, you indicate the number of U.S. small businesses are 14.3 million. Then you say the number getting SBA credit is 21,500. Well, first of all, there are 4.5 million, if we are talking about credit and the seeking of credit—you are not dealing with a 14.5 million figure. There are 4.5 million businesses seeking credit in the United States. So the universe is not 14.5 million. It is 4.5 million.

Now, I am going to take that one step further. We are not only talking about 4.5 million. We are talking about 4.5 million businesses that are seeking credit in their lifetime, in their lifetime, whereas your figure of 21,500 is a 1-year shot.

Is that correct?

Mr. STOCKMAN. That is correct, Mr. Chairman.

The CHAIRMAN. So let us correct the figures. We are talking about 4.5 million which is the universe which we are talking about; we are talking about the 21,500 figure as being a 1-year figure compared to the 4.5 million which is over the course of the business's lifetime.

Second, you are factually incorrect as far as the programs are concerned. You can add another 3,000 to the yearly figure as businesses receiving assistance under the SBIC program. So that figure comes to 24,500.

Now would you like to comment? You have a percentage which is obviously factually incorrect when you consider the facts that I have laid out. You incorrectly compare yearly figures with lifetime figures. As far as your point that only a small percentage is getting assistance, I would add to my query the fact that the administration is pushing extension of the research and development tax credit which is scheduled to expire at the end of this year. The revenue loss is estimated to be $1.5 billion. It is estimated that only 12,000 corporations use this credit, only 1 percent of all U.S. corporations, and yet, you are pushing an extension and saying that this is valid percentagewise.

So my first question to you is whether or not you consider the statistics I have given to be more apples and apples than yours, and secondly, to ask you to correlate the R&D credit example I have given to what you are claiming as being excessive.

Mr. STOCKMAN. Mr. Chairman, you can look at this in the greatest generalization possible or you can break it down to market sectors and get more specific. The total universe is 15 million and SBA loans are a small fraction of that. If you have better information that there are 4.5 million firms that are credit-seeking and have to finance things, fine, I will accept that. That means that SBA is serving five-tenths of the firms rather than two-tenths.

The CHAIRMAN. Let us stop there. You are the one that has been running around for a month misleading people with facts. Only 4.5 million seek credit over the lifetime.

Mr. STOCKMAN. I am getting to that, if you will let me finish.

The CHAIRMAN. Let us multiply the figure by the lifetime——

Mr. STOCKMAN. I am trying to say, Mr. Chairman, that in the presentation that we developed for today, I tried to go behind these roundhouse, ballpark figures, which I know can be made to argue one side or the other of an equation and dig down into where this money goes to determine how many of the firms in specific sectors get SBA support. Let us forget the aggregate for a moment. I have pages and pages of tables in here. Take, for instance, car dealerships. There are about 44,000 establishments in 1984. SBA made 220 loans. That is less than 1 percent of the market.

The only point I was trying to make is, and this is common sense, and every member of the committee knows it, a car dealer has to get financing every year because he has to finance the cars on his lot, his floor plan. Everyone is a credit-using firm and most of them go to banks. We know that from our experience and these numbers simply reinforce what happens to be the case.

Now, maybe 1 percent of the firms need some subsidized credit because they cannot go to the bank. But, I have to ask the question, Is any important or useful or significant national function being performed here when we help a small fraction of credit using car dealerships with a slight break on their interest rate because it has an SBA guarantee compete with their neighbors, the Ford dealer as opposed to the GM dealer, who have to go to the bank for the money?

Now I am saying, let us not argue about the 15 million or the 4 million or whether it is lifetime. Let us look at it case by case, sector by sector, and see what the size of the SBA role is within a year relative to the size of the market. I think the basic point we are making is more strongly supported by these data that I have presented to your committee. Much greater effort and work went into it than into this kind of glossy overview of the case for the program termination that we have in a couple of pages in this book on all of the budget changes that the administration has proposed.

The CHAIRMAN. You have made your case by facts or what you puport to be facts. I am going to meet you on your own ground. We are going to discuss facts, not philosophy.

On page 4 of the statement which you handed out to the press and to the Congress, page 88 in the detailed budget, you make the statement, that SBA loan subsidies go mostly to the economic strap-hangers, weak businesses who get repeated SBA loans. Some 53 percent of SBA loans were repeat customers and 77 percent of the 1983 first half SBA borrowers were repeat customers. Your numbers are wrong.

Mr. STOCKMAN. Yes, sir; the reason for that——

The CHAIRMAN. I am going to get it correct. You have had a month to peddle your misinformation.

Some 14.4 percent of 1982 borrowers were repeat customers; 16.4 percent of 1983 SBA borrowers were repeat customers; and 13 percent of SBA borrowers in 1984 were repeat customers.

Can you provide us an explanation for the difference between the figures you give to the President and the Congress?

Mr. STOCKMAN. The figures I had used originally and that were in the documents to which your referred, were provided to us by SBA. I would like to submit for the record the transmittal from SBA that provided that 70 percent figure. We were later informed by SBA that they had given us incorrect information and, therefore, we would correct the record here and now, just as you have done. I do not think it makes a material point, but, we had wrong information from the agency, and we are now correcting it. The correct information supplied later from the agency is in the second submission that I would like to put in the record.

The CHAIRMAN. The material point that I am trying to make, Mr. Stockman, is that your entire argument to the President, the Congress and the American people, is a conclusion based on statistics, statistics which I intend today to prove are false. That is the point.

Point No. 3, on page 89 of the budget document given to the committee by your office and the other document on page 5, you indicated that the default rate was 19 percent in 1979, 23 percent in 1980 and 19 percent in 1981. You then give the figure of payout on default loans as being $4,247 million. Now, this does not fall into the category of an erroneous fact; this comes out under the category of telling only half the truth to get the point across. Indeed, the actual loss rate, the loss that the Government actually sustains, is 6 percent—roughly 6 percent or 5 to 6 percent—and the loss sustained by the U.S. Government is not $4.2 billion, but, rather, after liquidation, and so forth, is $1.4 billion. You, obviously, in your statement for this hearing, come around to the same conclusion that we did as to what a fair presentation is, because in the statement for this hearing, you do include these new figures.

Now, the question is, the figures that you presented to the President, were they the same as the ones you are now presenting to the committee or are they the ones you are still circulating in this budget document?

Mr. STOCKMAN. Both figures are correct, and it is simply a matter of diagnosing what measure you are using.

The CHAIRMAN. I am not disputing the $4 billion. I am saying that you are only telling half the story.

Mr. STOCKMAN. No; I am not telling half the story. On page 20 I am telling both halves of the story, your half and my half. This document was printed on February 1 and the figures on the default rate for guaranteed loans are right, because default in the program means when a borrower defaults at the bank that originated the loan that SBA guaranteed. These are the precisely correct numbers. And when a default occurs at the bank level, SBA must purchase that loan from the bank, and when SBA purchases that loan from the bank, we have to lay out $100,000, paid out to the bank, an outlay from the Treasury, in order to cover our obligations on the guarantee. We then put it into our portfolio and it may be there for the next 8 to 20 years as we try to either work it out and collect from the borrower what the bank could not collect, eventually settle the loan, or write it off entirely.

Now, what I have provided in my testimony this morning is the final outcome of that credit cycle which starts with default at the bank level and these rates are right, 19, 23, and 19 percent for the years given, and where we ultimately end up with the chargeoff to the taxpayers. The figure you have used, Mr. Chairman, the 6 percent, is misleading. That figure is based on a denominator which includes every dime of SBA loans that have gone out up to the present date against the actual final chargeoffs up to the present date in the numerator.

But the point is the denominator is complete. The numerator is totally incomplete, because it will take us 20 years to find out what our final chargeoff is for any given loan.

Therefore, if we look at the older cohorts, Mr. Chairman, we will get as precise a figure as we can for what you seem to want to know, the actual final chargeoff figure to the taxpayers of the United States. I suggest that you look at page 20, line 1. You will see that for 1971 to 1974, $4.3 billion were put out in SBA guarantees. The maximum exposure that we are going to have on this is $598 million or about 14 percent because there is still that much outstanding. The intermediate exposure, the number I have talked about as the default rate is $787 million. That is how many of the $4.3 billion in loans the Treasury actually had to purchase between 1971 and yesterday. Some of these were able to be worked out after they went into the Treasury or SBA portfolio, but most of them were charged off.

If you look at the final column, $429 million of that $4 billion have already been charged off. That is a complete loss, 10 percent.

As I say in the text, another $58 million of that cohort is now in liquidation, which means we have given up on the loan, it is not curable, the firm has disappeared or it is never going to pay. If you add that, we have an 11.3-percent ultimate loss rate on that cohort already and we still have some loans that are outstanding, some of which we may never collect on and will experience additional losses that could go into the 12- or 13-percent range. That is the most complete picture that you can have of the ultimate loss rate to the taxpayers. The initial loss rate was 18 percent. The ultimate looks like it will be 12 or 13 percent.

One of the things that I have been saying, Mr. Chairman, is that in loans made in later years, we have had such a high initial default rate already. That is, the borrower defaulted at the bank level and SBA had to purchase the loan. Therefore, we had to spend money and create outlays.

If you look at 1978 to 1981, nearly $10 billion loans were put out under guarantee and already we have had to purchase $2.1 billion or 22 percent.

Now, that is the default rate, the technical default rate for SBA that we normally use. Some of these we will work out. We will collect one way or another. But probably 60 to 70 percent will be chargeoffs ultimately, complete losses, and we will experience in this cohort a 16- or 17-percent ultimate loss rate, in my judgment.

So, therefore, if we would bear down on this very carefully, recognize the distinction in terms between ultimate loss and initial default, look at the long-term credit cycle, I think it is fair to conclude conservatively, as I have, that 10 to 12 percent is the minimum ultimate loss and that means that the current level of lending is costing the taxpayers eventually, when the credit cycle is completed, $300 to $400 million.

The CHAIRMAN. Since 1972, over $24 billion in loans was disbursed at a cost to the Treasury of $1.4 billion. Actual loss rate of 6 percent. These are the statistics since 1972.

Mr. STOCKMAN. Mr. Chairman, if you ran a bank on that kind of observation, you would be bankrupt.

The CHAIRMAN. I am going to run the hearing, not you.

The testimony we had from bankers at the last hearing indicated that roughly was their experience, somewhere between 5 to 6 percent. So both at the bank level and at the level of the Federal Government, the figure is 5 to 6 percent. You are throwing in figures that will emanate from the 1981 recession. We are dealing with a perception by the President, by the American people, by the Congress that $4 billion was lost and that there is a 19- to 20-percent loss rate, and that is not correct. It would be fairer to say you are dealing with 5- to 6-percent loss rate which comes to somewhere around $1.4 billion. This is not insignificant, but it is a far different figure than these figures you have given here this morning, which they are not the figures you gave either to the President or to the Republican majority in the U.S. Senate.

Let me just tell you what was done here this morning to show the impression that the misuse of figures leaves. You mentioned the fact that there are 300,000 new business starts, and only 4,000 companies in 1 year had loans provided to them by SBA. Therefore, only 1.3 percent were getting SBA assistance. That is going right out over the television; 300,000 new starts, 4,000 companies in 1 year. Therefore, 1.3 percent were getting assistance.

Now, let me tell everybody out there exactly what it is you have done. The 300,000 is over a 6-year period. Therefore, what we are talking about is not 4,000 businesses that received assistance, but 24,000 businesses received assistance. Therefore, the figure is not 1.3 percent. It is 7.8 percent, using the same universe that you are using.

Now, that is what I object——

Mr. STOCKMAN. Mr. Chairman, that is not, no——

The CHAIRMAN. That is not correct?

Mr. STOCKMAN. No; that is not correct.

The CHAIRMAN. Let us go over them one by one.

Mr. STOCKMAN. Could I explain why?

The CHAIRMAN. No. I am going to go over each one of your figures; 300,000, is that a 6-year figure or a 1-year figure?

Mr. STOCKMAN. That is the number of new firms.

The CHAIRMAN. New firms.

Mr. STOCKMAN. But not the number of total firms in the industry. The number of total firms in the industry is the combination of the first column and the fourth column. In 1982 there are 1 million firms in these industries.

All right. So if you get 4,000 a year or 3,700 as I have provided it, then 4,000 out of a universe of 1 million is four-tenths of 1 percent.

The CHAIRMAN. What are we using the 300,000 figure for?

Mr. STOCKMAN. That is the change from one end of the period to another, but all of the SBA loans do not go to new firms. They go to existing firms and new firms. They go to anybody, and I was not saying that all the SBA loans go to the new firms.

I am saying that in an industry that went from 600,000 at the beginning of the 6-year period to a million at the end, SBA is making a couple of thousand loans a year. That may be important and we can argue about that, but I do not think it is statistically significant. That is all I am saying.

The **Chairman**. All right. Let us go ahead and show how the shifting baseline operation of yours works. In table 1 on page 7, where you list the SBA lending to bars, restaurants, hotels, and so forth, that table is entitled 1984 SBA lending to retail, wholesale and service industry firms. That is 1984.

Then in table 2, on page 10, you make the point that physicians and dentists, and so forth, are receiving huge amount of loans. For those of you who read the fine print you will see at the top of the page that this is not for 1984 only; this is for 1978 to 1984. So now you are using a 6-year period when you try to dramatize something on the negative side.

Mr. **Stockman**. No, Mr. Chairman.

The **Chairman**. All I suggest to you is it would take an eon to try to go ahead and make apples and apples out of this document that you presented to us. I am just going through it to show selective areas where this shiftiness exists to try to expose it for what it is.

Mr. **Stockman**. Mr. Chairman, could I have the privilege of responding on the point of shiftiness since you have accused me of shiftiness.

The **Chairman**. That is right.

Mr. **Stockman**. The reason I have the second table in there that cumulates 6 years is for one point. I said I want to make sure that 1984 is not an aberration. The first table, all of those 39 industries are 1 year's worth of lending. Maybe that was an aberration. Maybe some of these industries were distressed in 1984 and so they got a disproportionate amount of lending.

So in order to make sure that I was not misleading the committee or myself I took a selective number of these, since I only have so much time and so many workers, to see how much had been loaned over 6 years to make sure that table 1 was not an aberration, was not atypical. That is why I have provided table 2. I was not trying to be shifty. I was simply trying to reenforce the point that table 1 is a representative, typical 1-year portrait of SBA lending. The opposite of shiftiness.

The **Chairman**. Senator Bumpers.

Senator **Bumpers**. Mr. Stockman, you say you have made the argument at the White House in favor of eliminating SBA and I want to make two observations. No. 1, the 3-year authorization bill that Senator Weicker and I have introduced in the Senate actually cuts SBA spending, and I am talking about outlays, by over $725 million over the next 3 years. So it is not as though this committee or in particular Senator Weicker and I are trying to bust the budget.

It seems to me that that is an honest effort worth noting. Second, you made the argument to eliminate SBA, and one of the reasons we are in this predicament of having to go through these draconian cuts and making choices none of which are attractive to us, is because in 1981 there was an argument that if we just cut taxes 25 percent and double defense spending we could balance the budget.

Do you not feel responsible for any part of the deplorable situation we find ourselves in now?

Mr. STOCKMAN. Well, Senator, I think we are all responsible.

Senator BUMPERS. I am not. I did not vote for those tax cuts.

Mr. STOCKMAN. Well, I am going to make another point. You may not have voted for that measure but that measure did not create the predicament that we have today. Over 20 years we have done all kinds of things that add up to 24 percent in spending of GNP and 19 percent in taxes, and that gap is our problem. Republicans and Democrats, liberals and conservatives, in some way or another over time have all contributed to the impasse that we are at today.

Senator BUMPERS. But that gap never was historically that large.

Mr. STOCKMAN. That is, Senator, because the spending has gone up. The 19 percent of GNP that we are taking in in taxes is higher than the average for the last 20 years from 1962 to 1980. So it is not that we are taking lower taxes from the people than we normally have or that we made ends meet with for 20 years it is that we are doing a lot more spending, and therefore, we have to find ways to get it down.

I do not think that if we had a balanced budget there would be any disposition to hear me give some analytical and philosophical reasons why SBA is one thing that can be dispensed with.

But under these circumstances, when our spending is way up in the stratosphere compared to what we have had in the past, and our taxes are as high as they have ever been, I would just hope the committee would look at this and say are you giving up too much that is important.

Senator BUMPERS. Well, Mr. Stockman, to me the proof is pudding. I made a brilliant speech on the Senate floor the day we voted for the tax cut, and there were only 11 in the Senate who did vote against it. I admit that.

But I said then, and I have never changed my mind, that if we did that, and if we spent the amount of money on defense that the President was asking for, we were going to create staggering deficits. We did it, and we have created staggering deficits.

So there is not any question about what the outcome of that has been. Now, getting down to the matter at hand, we had some interesting testimony here the other day that I wish you could have heard by a number of, admittedly, our big success stories in SBA.

But let me give you one example.

Cray Research which is a Minneapolis-based high technology firm. I believe an executive vice president of that firm was the one who was testifying, and he pointed out in 1976 they were really down on their honkers. They were going down, and they had exhausted every possible source of credit.

They finally were able to put a package together because an SBIC gave them a helping hand. They had an idea, and it obviously turned out to be a good idea, but if it had not been for SBIC giving them a helping hand, they would not have made it. And in 1984, they paid $20 million in income taxes and in 1985 they will pay $30 million.

There is a list of 10 firms that would have had a hard time making it or would not have made it. Apple Computer, Federal Express—and I know that story because Federal Express originated in my State. They even asked me to give them money out of my emergency fund when I was Governor. Intel, Rolm Corp., Cray Research, Pandick, Lifeline Systems, Digital Switch, NBI, and Network Systems. That is just 10 firms that have been helped by SBIC's since 1958 and last year those 10 firms paid $200 million in income taxes.

Is that not impressive to you? We are talking about people who would not have otherwise received credit.

Mr. STOCKMAN. Senator, let me answer it this way. One thing I do believe about we in Government, we are competent. If we set out to help somebody, we are going to end up with some examples of where we have helped, and that really is not the issue here, that after years and years worth of lending you can find some very impressive examples of people and firms that have been helped.

The question is what happens in the economy generally and how many thousands of firms have been helped by entirely private venture capital investors that are doing the same thing as the few examples that you provide here today and could we get by without the small fraction of help that comes from SBA.

You mentioned Apple Computer. I was fortunate to have a conversation with Steve Jobs the other day who is the founder and he said basically, "I would not touch SBA with a 10-foot pole."

Senator BUMPERS. He says that now, but he would not have said that——

Mr. STOCKMAN. The point is his testimony on the subject was that most people in high tech that he knows do not bother with SBA. There are plenty——

Senator BUMPERS. That is the "pull up the ladder, Jack, I am on board syndrome." [Laughter.]

Mr. STOCKMAN. There are plenty of venture capital firms out there helping these kinds of enterprising new businesses get started as a result of the tax policy changes that we have made—capital gains in 1978, rates in 1981.

I am sure it helped a few. The question is do we need it. Would not the basic process of small business startups, entrepreneurial activity happen anyway and, therefore, can we afford it?

Senator BUMPERS. Let me answer the question. I am not on the witness stand but let me answer the question you have just raised. In a survey of 951 of the 8,900 banks in the country, 82 percent of them said they would not have made these SBA guaranteed loans, that they would not have made those loans or they would have made them on much more stringent terms if it had not been for the guaranteed loan program.

So is that not the answer to your question? You are suggesting that anybody whoever got a guaranteed loan could have gotten it otherwise. Yet the survey is quite the opposite.

Mr. STOCKMAN. I am not saying that at all. No, Senator, I am suggesting the opposite of that. By definition, you cannot get an SBA loan guarantee unless you cannot get credit elsewhere.

So to say that we did a survey of banks who made loans with SBA guarantees and they testify that these loans would not have been made only proves that the basic condition of the program is being enforced. It does not prove anything else.

My point is why should a very small fraction of firms—who just are not creditworthy, who cannot show how they are going to make a profit to lenders all across this country, including finance companies, banks, S&L's—have the privilege of having the taxpayers stand behind them when all of their competitors do not get that benefit and pay higher interest rates as a result.

Senator BUMPERS. Incidentally on that point, that is not necessarily true. The testimony here has been that for SBA guaranteed loans, the interest rate is about 2 points or more above the prime rate, and that does not include the 1-percent guarantee fee. That is not exactly a bargain basement sale on interest rates.

Mr. STOCKMAN. Senator, if I may respond, that is true with the guarantee since there is still 10 percent exposure to the bank.

Senator BUMPERS. Well, we are proposing to eliminate virtually all of the direct loans.

Mr. STOCKMAN. The question is, if the average SBA loan guarantee has an 11-year term on the loan, what would the bank charge if there were no SBA guarantee whatsoever for that credit that has already been turned down by all the other banks in the area? The answer is probably 25 or 30 percent. It is such a high risk.

What the guarantee does is remove that risk down almost to a normal lending rate and that is a big advantage to the firm that gets it.

Senator BUMPERS. Is there no merit at all, Mr. Stockman, in the proposition under which SBA was founded in the beginning, and that is that there are people out there who may not be creditworthy according to their balance sheet on the President's desk but who are, indeed, enterprising, energetic, creative, possibly with new ideas. I just read you a list of 10, and there are literally hundreds of lesser stories like that. Is that not the whole genesis of SBA, to provide small business people who have ideas but who simply cannot get long-term credit an alternative to give them a chance. Is that a bad idea?

Mr. STOCKMAN. That is the original idea, but I think what I have been trying to say in this testimony is if you could show that 90 out of 100 small businesses with enterprising ideas and a new mousetrap to sell could not get credit, could not get financing that there was some vast market imperfection, then you could make a case for an SBA-type lending program.

Senator BUMPERS. I just read you a list of them.

Mr. STOCKMAN. Those 10 firms do not prove anything because I can give you a list of 10,000 who were also probably equally shakey in their original days but they had an idea and somehow they persuaded a venture capital firm or even a private investor to roll the dice, put some money in and the payoff came.

But there is no showing that the overwhelming bulk of small businesses in this country cannot get credit either for their short-term working capital needs or in the case of longer term investments for their longer term needs.

Senator BUMPERS. Mr. Stockman, you just said a moment ago that these people are getting credit because they are not creditworthy at the banks.

Mr. STOCKMAN. That is right.

Senator BUMPERS. How does that square with what you just said?

Mr. STOCKMAN. That is the heart of the free enterprise system, the market. I am not going to get overly Adam Smithian about this, but the point is——

Senator BUMPERS. Oh, you read the paper this morning, did you not?

Mr. STOCKMAN. All right, but now, look, the point is, What are the potential credit demands of our society? I mean, if all of us in the room got together, we could think of a billion dollars, worth of loans we would like to have to do all kind of wonderful things for the country or ourselves, and the credit demands enormously outweigh the supply of savings to finance them. Therefore we have to have a choosing mechanism. We have to have a rationing mechanism to determine who gets credit and who does not.

We have a banking system consisting of about 30,000 institutions that specialize and thrive or succumb on the accuracy of their judgments. They are the ones that do the credit rationing in this system. They are the ones that have to make the choices on who is creditworthy and who is not.

I think they are doing a pretty good job. There are no big gaps where some important public purpose is not being filled, and that is why we do not need SBA.

Senator BUMPERS. But they are all in here testifying. The bankers are all in here testifying that SBA works.

Mr. STOCKMAN. The only ones who have testified are the ones who make profits out of writing SBA guarantees.

Senator BUMPERS. Well, I certainly do not expect banks that lost money to come in here and promote it.

Mr. STOCKMAN. Well, of course, they would not. That is right.

The CHAIRMAN. Well, then, why do you not wait and hear the testimony of the three businesses that are going to testify right after you? They are not bankers. They are businesses.

Senator BUMPERS. Let me cover two other points. You and Senator Weicker got into this discussion about the real world, the 4½ million businesses who have asked for credit over their entire lifetime and the some 20,000 people that SBA helped in 1 year.

Incidentally, that comes out to over 500,000 businesses. I never did hear that figure. Maybe it was mentioned, but 500,000 businesses have received SBA loans since 1953, and when you consider that as opposed to 4½ million, I do not know what it comes out to, 11 percent, but I do not think whether it is 3 percent or 10 percent is really all that relevant. I do think it is important that we get the figures straight so that people are not misled as the chairman has correctly probed.

But the other point I want to make is SBA was set up for precisely that purpose, to make a very small number of loans to people who simply would not quality for credit any other way. I mean, it was a generous, thoughtful and quite frankly economical proposition. What is wrong with that?

Mr. STOCKMAN. Senator, let me answer you then. You ask me what is wrong. Let me respond.

Senator **Bumpers**. You keep talking and you have all these charts here, the small percentage. And incidentally, what do you have against carwashes and beauty shops?

Mr. **Stockman**. I have nothing against them. I think that the more of them the better, and there are thousands of them out there. They work hard, and all of them at one time or another need credit. If you own an auto dealership you have to finance your inventory. They go to the bank.

Senator **Bumpers**. SBA does not finance auto dealers inventories. They do not do floor-planning of automobiles which every automobile dealer in the United States uses. They do that through Chrysler and General Motors and the bank. They do not do that through SBA.

Mr. **Stockman**. Well, we will provide some information on that.

Senator **Bumpers**. All right.

Mr. **Stockman**. But the point that I am making is that almost every business has credit needs of one type or another and I am not saying that SBA should do 5 percent versus 1 percent. I am trying to make the opposite point. This glass is almost empty at the moment because I have been drinking it.

Now, the point is most of the small businesses in this country get financed by the financial institutions that we have. That is proper. I raise the question. You said, what is wrong with it?

Is it fair for a business firm who, let us say, is paying 12 percent at the bank right now because there is no guarantee to have to compete with a new guy who opened shop next door who is getting a loan for 10, or 10.5, or 11 percent, who has really nothing to offer that the market is not already being supplied with but he got an SBA guarantee because he was turned down by several banks. I do not even think that is fair.

Why should somebody who has everything on the line, his life savings, and has worked like a dog for 20 years, have to compete with a new guy on the block who received an SBA loan to set up a new pizza parlor? I just do not see why that is fair.

Senator **Bumpers**. First I want to cover this chart and then I will quit. But I have always maintained that most of us who consider ourselves as having been fairly successful in this world are so because either we got very lucky at some point in our life, or Government gave us a little helping hand at some point in our life, or we chose our parents well. Now, I happen to qualify in all three departments. [Laughter.]

I do not see anything wrong with any of those. You want to cut student loans, for example, and I am telling you, that here is one Senator who would not even be sitting here if it were not for the GI bill. So I just happen to have a blind spot where it comes to student loans, because I know what it did for me.

But you see, I think philosophically maybe we do have a disagreement. I was in business one time, and I do not like for Government to compete with people who pay taxes. And I did not like to compete with people who did not pay taxes. It was unfair.

But on the other hand, I also had a competitor at one time in the retail business who had an SBA loan. He was a good competitor and he got along just fine. And I always felt the more competition there was, the more business there was, and it turned out that way.

I do not think people resent somebody getting an SBA loan at 13.5 or 14.5 percent who just simply was not going to get into business any other way, but let me go to the chart here.

Here is something that we have labored with here in the committee and have not been able to resolve and perhaps you can enlighten us on it. And that is this. And I am basing this on an internal memo from OMB. I do not know whether this has been leaked or what, but I do want to ask you this: You point out in your testimony here that you want to close this place down and you want to sell this portfolio. Now, the percentages of the face value of the loans which you expect to get, that is, what you expect to collect is really shocking, 19.3 percent according to this memo.

And incidentally, let me ask you this. How are we going to save $1 billion something next year when the appropriation is only $700 million?

Mr. STOCKMAN. Senator, I have provided a table in my testimony that shows line by line how we get that, and if I could I would like to refer you to it.

Senator BUMPERS. Please do. What table is that?

Mr. STOCKMAN. It is on page 23. The appropriations do not cover the entire amount of SBA spending. That is one of our first points since a lot of SBA loans are development company loans and SBIC loans that are originated in the Federal Financing Bank [FFB]. But, that is still Government spending because the FFB does not have any money. It has to borrow from the Treasury to finance everything it puts out.

In this budget we have consolidated all off- and on-budget spending, and we are now, for the first time, counting total spending. So how do we save the money? It is indicated in lines 1 through 6 how we arrived at the $1.4 billion.

Senator BUMPERS. You sell 671 million dollars' worth of the portfolio next year?

Mr. STOCKMAN. That is right.

Senator BUMPERS. Now, that brings me to the very line of questioning that I wanted to ask you about. You show $671 million in sales of portfolio next year; $610 million in 1987; $549 million in 1988, and $1,830 million overall.

Now, what I do not understand is we have, according to your statistics $17,326 million, that is the face value of both the direct and the guaranteed loan portfolio.

Mr. STOCKMAN. But the guaranteed loan portfolio, Senator, is not available for sale.

Senator BUMPERS. Until they default?

Mr. STOCKMAN. Until they default, and that is 20 percent at best. So you have to ignore 80 percent of the guarantee total because that is not available for sale. That paper is held by banks.

I think to focus on this question, Senator, page 26 indicates how we arrived at these figures. If you would look at the bottom of page 26, on line 21, we have indicated that we think you could sell about 10 billion dollars' worth of assets, loan assets in the SBA portfolio, paper that they own, both direct loan assets and defaulted guarantees from prior years now owned by SBA.

Then the question is, well, what could the sales rate likely be. What I have done for the committee here is to indicate that by category we assume a yield or sales rate that differs enormously depending on the kind of loan that you are actually proposing to sell.

In other words, this $10 billion consists of some very high quality paper and some absolutely worthless paper, and the blended average sales rate that we are assuming is very conservative.

I might explain this table, Senator. The column called "Low" in about the middle of the page is the conservative estimate that we used in the budget for the sales rate or yield.

Now, it could be better. We hope it is better. If the market is willing to bid more for these loan assets, then we will get a higher sales yield. We will get more receipts into the budget. We will reduce the deficit more.

But again, trying to be prudent, I did not want to overpromise how much we could reduce the deficit by selling SBA loan assets when we were not quite sure yet how the market was going to respond. So, we used a very prudent number.

Remember when you sell it, we are going to sell them at whatever the market will bid. If the market thinks that these are more valuable assets than we have assumed conservatively, they will bid not 20 percent on average but 26, 32, 50. We will get a lot more money. We are not giving up anything.

Senator BUMPERS. What has SBA's collection rate been on direct loans?

Mr. STOCKMAN. SBA's collection rate on direct loans, I understand, is somewhere in the 80 percent range or 85 percent range.

Senator BUMPERS. Why would you want to sell a portfolio that they have been collecting 80 percent on for about 25 percent?

Mr. STOCKMAN. Well, we are not selling it for 25 percent. Look at the top of the page on the direct loan part of this portfolio, general business loans. That is kind of the prime asset, direct loans that are in current payment status. So if some buyer came in, he could see that this was not a loan that needed to be cured. It was not in delinquency or anything. We are assuming at minimum 40 percent, but you could get as high as 60 percent.

Now, you say, well, why not 85 percent? The answer is to look at the interest rate on it. The average interest rate is 9 percent. That is well below the cost of money in the market for the most part to borrowers today.

So any loan that has a below market interest rate on it sells at a discount, just like the new Treasury bills that we put out or some of the paper that is being issued in New York. If you have a below market interest rate on it, the loan sells at a discount from its face value.

Why? Because it costs you to service that asset over the holding period if it is yielding less than the current market rate. So now the way we have constructed this is to go through it very carefully, class by class, looking at the quality of the paper, the interest rate on the paper, the maturity of the loans, the loss rate that has been experienced on this kind of paper held by SBA in recent years, and out of this we came to conservative assumptions.

But I hope we can end our argument by saying that if the market thinks the paper is worth much more it will bid more. This is going to be an auction bid process. We will get more money, and your question will be mooted. So I do not think we have to worry about getting too little for the SBA loans.

Senator BUMPERS. In any event, small business management of the portfolio would yield more than your sale, would that be correct?

Mr. STOCKMAN. Not on a discounted present value basis unless you think there is a totally imperfect market out there for loan assets.

Senator BUMPERS. We can predict what the future of SBA management is. It is $9.6 billion. Is that what you are guaranteeing?

Mr. STOCKMAN. Look, I do not want to guarantee anything because I know you have paper here that is made to people who were not creditworthy. That is the purpose of the program; that is what you all have been arguing this morning. So it has risk on it.

I know that in this $10 billion you have a lot of below market interest rates. By definition, price and interest rates trade off in the market and you get a discount if you try to sell paper with a below market interest rate.

So as a result of that, when somebody goes in to assess, to evaluate or appraise the loan paper that is being put out for sale, I cannot guarantee this committee what they are going to finally conclude down to the last fraction, but I think they will pay whatever it is worth.

If we have assumed that it is worth less than it really is, the Government will get more money. We will have less deficit. If we are right, then you will get the $2 billion over 3 years.

But you really cannot object to that. It is impossible for the market to pay less, I think, than the actual worth of these assets, and SBA cannot collect any more than the actual worth of these assets.

Senator BUMPERS. Mr. Chairman, let me just make this observation. No. 1, I predict the administration is going to lose this fight. As I say, we have already agreed, in S. 408, to eliminate the direct loan program except for veterans, the handicapped, and MESBIC's, and SBA is going to continue to make guaranteed loans, in my opinion. And as long as they are, they might as well, since they are already there and have the personnel, collect these direct loans.

According to a computation which the economist on the minority side has done in computing present value of all those loans, our staff still maintains that your proposal yields inordinately low returns to the Treasury and also your figures are wrong based on present value of those portfolios. I am going to submit this for the record, and you and your staff can look it over and quarrel with it if you would like in writing to the committee later.

With that, Mr. Chairman, I would ask unanimous consent that this computation of the value of all these loans and present value be inserted in the record.

The CHAIRMAN. All right. It will be so ordered.

[Material follows:]

OMB Sale of SBA Loan Portfolio

Present Value Calculations

Year	Expected Revenue (millions)	Discount Factor****	Present Value (millions)
86	$670	.9066	607.43
87	610	.8295	505.98
88	549	.7731	424.41
89	488	.7314	356.93
	$2317.00		$1894.75

SBA Collection of Loan Portfolio*

Year	Payment Expected*** (millions)	Discount Factor****	Present Value (millions)
85	$1343**		
86	1317	.9066	$1193.99
87	1247	.8295	1034.39
88	1131	.7731	874.38
89	1013	.7314	740.91
90	886	.6933	614.26
91	772	.6571	507.28
92	673	.6229	419.21
93	581	.5904	343.02
94	503	.5596	281.48
95	434	.5304	230.19
96	375	.5028	188.55
97	324	.4766	154.42
98	277	.4517	125.12
99	236	.4282	101.06
00	1190	.4059	483.02
	$12301		$7291.28

Total Present Value of Revenues Under OMB Proposal	$1,894.75
Total Present Value of Revenues Under SBA Proposal	$7,291.28
Loss to Treasury from OMB proposal	$5,396.53

*This includes BLIF, DLF and FFB loans.

** 1985 is not added so that this revenue stream can be compared to OMB sales revenues which are based on portfolio in 1986.

***This expected payment allows for expected losses.

****Discounted at ten-year Treasury note rates assumed by OMB in FY 86 budget.

(Prepared by Small Business Committee,
Minority Staff)

Mr. STOCKMAN. Senator, could I just respond briefly? We will be happy to look at this, but I somehow do not think I have gotten one basic point across. We are not offering to sell the assets at 40 percent. We are offering to sell them, period.

If the market bids higher like 60 or 70 percent after discounting for the interest rate and the risk, fine. We will get more money. This is a budget estimate. This is not an advertised fixed sales price. We are not telling anybody that wants to, to come in and buy these assets at an average of 20 percent. We just wanted to be prudent in the budget and not overpromise.

We tried to do something here which is the opposite of what we normally do which is to overestimate the revenues and underestimate the spending, and we end up with a worse deficit.

Senator BUMPERS. I used to be Governor. I used to work both sides of that street.

Mr. STOCKMAN. What I am saying is we are going to sell them at any price the market will bid, not a fixed price, and if we get more, fine, we will reduce the deficit more. There really is not an issue of appraisal here I do not think.

Senator BUMPERS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. Mr. Chairman, Senator Bumpers has asked some of the questions that I was going to ask about the portfolio. If you would turn, Mr. Stockkan, to page 20 where you have in this chart, I gather, you have made in the period of time, 1971 to 1985, $24 billion of loan guarantees. Is the $10 billion the amount still outstanding?

Mr. STOCKMAN. Yes.

Senator BOSCHWITZ. That has not been either purchased by the Government or has been paid off?

Mr. STOCKMAN. Yes; but that is an important point, Senator, because we do not know what the experience is going to be on defaults and ultimate losses on that. Since it is still outstanding but has a long way to go to term, it is hazardous to use the $23 billion total as the denominator for calculating your loss rate. $10 billion of it is very immature paper, and we know over the 11 year cycle a lot of this paper goes bad with the passage of time.

Senator BOSCHWITZ. I do believe that the SBA does finance inventories. In your conversation with Senator Bumpers, it does finance inventories. It does not floorplan, however. Is that not correct?

Mr. STOCKMAN. I think it finances inventories in a variety of retail businesses but it is hard to say what the money is going for. It is all fungible.

Senator BOSCHWITZ. I did not realize that the SBA would grant loans of such a long duration that loans made in 1971 would still be outstanding.

Mr. STOCKMAN. Out of this cohort, nearly $600 million is still outstanding, and we do not know the final experience on it.

Senator BOSCHWITZ. Are the older loans, I presume, not as good as the newer loans?

Mr. STOCKMAN. Well, I think there is a decay curve over time. That is what seems to be the evidence that indicates that you will get additional defaults.

Senator BOSCHWITZ. The column all the way over on the right indicates that you have already written off 6 percent of the loans that you have made during this period, is that correct?

Mr. STOCKMAN. That is the bottom line, but that is the line that the Chairman uses. It is the misleading one, because that is simply $1.431 billion divided by $23 billion.

In other words, the chargeoff to date is $1.4 billion. The total disbursement over in the first column is $23,821 million. You divide that into the charge-off to date and you get 6 percent.

But the point is you have a lot of immature loans in the $23 billion disbursement total, and you have only final, ultimate chargeoffs in the $1.4 billion total. But, we know there will be a lot more chargeoffs as the cycle goes forward.

Senator BOSCHWITZ. The third column from the right or the $3.9 billion, those are loans that the Government has had to purchase back?

Mr. STOCKMAN. That is right.

Senator BOSCHWITZ. Because of nonperformance?

Mr. STOCKMAN. That is right. The bank simply has the option to come in and say the borrower is not paying and activate a Federal obligation to purchase the loan. Now, when we do this, it creates direct outlays. We have had to outlay $4 billion to buy the paper that you see in that column.

Senator BOSCHWITZ. What has been your experience with respect to loans that you have purchased? What percent of them will default?

Mr. STOCKMAN. Well, I think a good way for you to see this, Rudy, is to look at the 1971–74 cohort. Under the defaulted loans purchased, you had $787 million. About 18 percent of the original total was purchased.

To date, we have already charged off $429 million. If you add $58 million to that, because we have those in liquidation right now, you have somewhere in the range of $490 million that you have charged off.

So we have charged off $490 million of the $787 million that we had to buy or about two-thirds.

Senator BOSCHWITZ. What part of the $4 billion that you have there will you write off, in your judgment?

Mr. STOCKMAN. I think well over half, just based on the experience of the first cohort. Let me do the math here quickly.

Senator BOSCHWITZ. Therefore, you think the default ratio will be 14 percent or so?

Mr. STOCKMAN. It could be in that range. Of the oldest cohort here, we have purchased the $787 million that went into default that the Government had to buy. When you add the $429 million charged off with those that are in liquidation right now, we have or will shortly have, written off 62 percent of the original default purchases for that older cohort.

Senator BOSCHWITZ. But in the guaranteed loan portfolio you have either purchased or written off—during this period of time 22 percent, something like 22.4 percent, or the totals of the third and the fourth columns.

Mr. STOCKMAN. Yes.

Senator BOSCHWITZ. You purchased the 16 percent that is still in the column because presumptively they were not performing?

Mr. STOCKMAN. Yes. That is a pure mechanical test. If the loan is not performing after a certain period of time, the lender exercises his obligation. But, I would note also that most of the SBA guarantees were concentrated in that third line. If you will look at the 1978 to 1981 cohort, nearly $10 billion worth of disbursements in that 4 years, we have already purchased at default 22 percent of those loans or $2.1 billion.

Now, that suggests to me that this is a weaker cohort of loans than the prior cohorts, and that the ultimate chargeoff on these loans is going to be much higher than the 61 percent chargeoff that we have experienced on the oldest cohort.

Now, if that is the case, you are going to have a very high default rate in that big batch of loans that are just coming into midlife at the present time.

Senator BOSCHWITZ. Without considering what percentage of the loans that you bought, or the 16 percent that the Government has already bought, what percentage of those defaulted and those that we eventually writeoff at 6 percent have been written off?

The chairman noted that banks have a regular loss ratio of 5 to 6 percent. Are you familiar with that figure?

Mr. STOCKMAN. No. I think that is quite high. I do not think it is that high at all. I think it is 1 percent or 2 percent at best.

Senator BOSCHWITZ. Oh, I think it would be less.

Mr. STOCKMAN. Or less than 1 percent, yes.

Senator BOSCHWITZ. I would have to respectfully disagree with the chairman that regular banking institutions have loss rates of 5 or 6 percent. I would think that they would be much below 1 percent.

The CHAIRMAN. The statement I made, Senator, was, as testified to on small business.

Mr. STOCKMAN. SBA guarantees.

The CHAIRMAN. SBA guarantees.

Senator BOSCHWITZ. Oh, the Chairman was not saying that banks by and large have that?

The CHAIRMAN. No.

Senator BOSCHWITZ. Oh, the chairman was not saying that banks I must tell you, Mr. Stockman, that by and large I sympathize with your view point that the SBA probably is not cutting broad swath in the marketplace. In my years of business, unlike the Senator from Arkansas, I never met anybody who was involved with the SBA, and I knew of no one in my line of business that was involved with the SBA.

That does not mean, of course, there were none, but when I got here, I became much more involved, and I suppose if I had been a lawyer representing people, I would have been aware of it. But I was not, in my business career, aware of anybody who had been involved with the SBA, and in all my conversations with other businessmen, I have no recollection that anybody ever said "go down to the SBA and get a loan guarantee."

I might say that some businesses are characterized as somewhat tenuous at their outset—certainly mine was, even at some later dates it was somewhat tenuous. But in all those conversations I had with businesses in the same predicament, I did not meet anybody who was involved with the SBA.

However, I am very aware that when I started my business, if I had been a woman, it would have been much more difficult for me. I did not need the money. I turned my inventory rapidly enough at the very beginning so that I did not need money, but eventually I did as I expanded.

I think it would have been much more difficult for me to borrow if I had been a woman, a black woman, or a member of a minority. It would have been much more difficult. So while I am in sympathy with you and the general objective of getting the Government out of the business of guaranteeing that the market should really choose for itself, I believe that I would support the idea that there are areas—domestic, for example. I also like the SBIC quite aside from the fact that it helped Cray, which is a local company in my State. But, nevertheless, in my judgment, the SBA has provided seed capital where the normal market system might not have.

I think that capital is difficult to come by for certain segments of our population so I will support some type of an adjustment to the SBA but I will not support an adjustment that would not make credit available where the market does not choose to do so in the kind of a pure fashion that I would like it to But I do look at these figures, and I think it is a very good presentation. I noted, too, as you were going through it, that there seemed on some pages to be 1 year loans. That is why I asked the questions—as you went along—about one-year loans and the accumulation of several years of experience in the marketplace.

But I think it is an extraordinary presentation and that the SBA probably does not have a large place in the marketplace. I think that the marketplace does not choose among its borrowers in precisely the way that you and I would like it to choose and so I would support some type of Government programs that would make those choices possible. That is more in the form of a statement than a question.

Mr. STOCKMAN. Senator, if I could just respond on one point, I appreciate what you said. I think the phrase you made is the operative question on this whole issue. The marketplace has not chosen precisely in the way that you and I might like it to.

That is what we are doing with SBA. We are trying to make somewhat different choices. What my testimony is about and my objection is about is I cannot figure out what the logic of those choices are in the main for most of this guaranteed lending, other than a general desire to help small business.

I am raising the question to this committee, is that enough of a reason, is that enough of a purpose to incur the kind of cost that we have. Now, maybe there are some more targeted purposes that somebody could specify including only venture capital of a very high risk nature through an SBIC-type mechanism on which you might make a more powerful case.

But in terms of just the generalized guaranteed lending that dribbles down into all these sectors, I cannot get my finger on what that difference is that we are trying to promote as a result of intervening into market outcomes.

Senator **Boschwitz**. We have a very active Hispanic chamber of commerce in Minneapolis with which I have also been very active and I have helped some of them get through the throws of getting an SBA approval. This is the reason that somebody involved in business would almost not go to the SBA because it is usually much more complex than being handled by a bank.

But only several of those people present there—and I think there was a total of about a dozen, only three or four of them had received SBA loans. I am certain that they would not have obtained the proper kind of financing from the banking system had there not been the SBA.

The **Chairman**. I think before I move to Senator Sasser that the recent recession that we have just been through would very definitely respond in one way to your inquiry as to what the purpose is. In that particular instance, it was the long term of the lending that helped a lot of people keep their head above water.

The General Accounting Office in its report to the Congress or the Comptroller General, rather, dated April 25, 1983, pretty well sums it up. He says,

> Lenders indicated that the 7(a) program has several important advantages. It allows them to make long-term loans to small businesses that would not be made without the guarantee. Lenders also commented that the guarantee enables them to finance new business ventures that lack a track record and to make larger loans than their lending limits permit. Additionally, the program extends credit at interest rates comparable to rates paid by other small business borrowers even though most loans have longer maturities and a higher degree of risk. Vastly, it helps expand available credit to small businesses and others by letting lenders sell the loans to investors. Lenders do not perceive the program as causing increased interest rates or excluding other small business borrowers from their local credit market. Also the impact of the 7(a) loan program is significant in terms of satisfying small businesses long-term capital needs.

That is very succinct statement in the report by the Comptroller General as to what is sought to be achieved.

Senator **Boschwitz**. Mr. Chairman, if I may comment, I noted that Senator Bumpers also pointed out that 82 percent of the banks that were surveyed said that they like the SBA loan guarantees.

I suppose if I were a lender—and I have been on the board of a bank—and even there I might state I did not get involved in SBA guarantees, I would respond in just that way. I think it is a hell of a program for the lending agencies, banks and other people. We have just gone through the process of throwing a few billion dollars more of the banks' risks onto the Government. If I were a bank, I would love the program.

The **Chairman**. Senator Sasser.

Senator **Sasser**. Thank you, Mr. Chairman.

Mr. Stockman, you have been quoted as saying that the Small Business Administration is a rathole, a billion dollar waste. Do you think that is a fair characterization of the Small Business Administration and do yo stand by that statement?

Mr. **Stockman**. Well, I think I would stop at the billion dollar waste.

Senator **Sasser**. So you are retracting your previous slandering characterization of the Small Business Administration as a rathole?

Mr. **Stockman**. Well, if you want to put it that way, fine.

Senator SASSER. Frankly, I resent that characterization of an agency of the U.S. Government. The SBA is staffed with a number of dedicated civil servants who over many years have sought to help the small business people of this country. I would admonish you that you are not performing any service for your office or for this administration by using. that sort of term to describe an agency of the U.S. Government that I think is dedicated to helping the small business people of this country.

You might disagree, of course, with the effectiveness of SBA's programs. That is your right. You might also have your own views on how SBA ought to be changed. But to disparage those associated with the agency and the small business community is unpardonable.

You indicated that in the film shown earlier the President was simply reading a script prepared by the Small Business Administration, and that after conferring with you on the budget, he was prepared to back you in your moves to abolish the SBA, is that correct?

Mr. STOCKMAN. Well, that is a variation of what I indicated. What I said was the issue of whether to absolish the SBA lending programs that I had recommended was a major issue in the administration budget presentation. It was appealed by the agency involved.

A strong case for the merits and services that SBA lending provides was made by the Administrator. He did an able job. I made the other case. The President did not have many choices. He had a big deficit. He decided in this instance that while the lending programs are not terribly objectionable, they are not so important that we need them, and if we can save some money, let us do it. And that is the decision that he made.

It was directly put. It was an appeal, a presidential appeal, and you are aware of the budget process. Thousands of things are decided and only a few dozen actually get appealed, and this was one of them.

Senator SASSER. So the President of the United States has decided that he wants to abolish the Small Business Administration. Is that what you are telling this committee today?

Mr. STOCKMAN. He has decided that the advocacy function is important and wants to keep it. The help the SBA provides in procurement particularly in military procurements so that small business gets a fair shot, is also important. He wants to keep it.

He thinks that the focus on minority technical assistance is important, and we are keeping that. Finally, he has decided that we need some independent vigorous agency to remind everybody making policy in Washington, whether it is tax, regulatory or whatever, that small business is a critically important foundation of our economy and needs to be considered. He believes all that.

What he has decided, and our budget reflects it, is that the lending programs, direct loans and guarantees and the other lesser programs are not that critical, not that essential, cost us money, and we cannot afford it under the circumstances we are in.

Senator SASSER. So the President has decided after consultation with you to gut the Small Business Administration by doing away with the lending capability of that agency.

Mr. STOCKMAN. The lending part of it.

Senator SASSER. That is what you are telling us today.

Mr. STOCKMAN. That's right.

Senator SASSER. That is correct, right?

Mr. STOCKMAN. Well, you are describing this. I would not describe it that way.

Senator SASSER. This means that many people who aspire to be entrepreneurs, who aspire to own their own small business but might be a marginal credit risk in the eyes of a commerical bank, will not have a shot at getting the financing necessary to open a business.

Mr. STOCKMAN. I disagree with that wholeheartedly and 100 percent.

Senator SASSER. Let me just——

Mr. STOCKMAN. Well, let me answer your question since you asked it. The evidence is that hundreds of thousands of new firms are started every year, and that hundreds of thousands of people have the aspiration to go into business or to leave the employment they have now and do it on their own.

The evidence is further that only a fraction of these are helped to achieve that dream by the SBA; 95 percent I would dare to say do it on their own because they have saved, they have gotten their uncle to underwrite or cosign a loan, or they persuaded a bank that they can make a go of it, and that they have the talent and competence to do it.

So to say to those 95 percent of the hundreds of thousands of people every year who launch a small business, that there is no hope for you is wrong. There is complete hope for them. We support them thoroughly.

We are only saying to the few who have relied on SBA in the past you are going to have to make your own case now.

Senator SASSER. But the lending phase of SBA, as far as you are concerned, ought to be done away with. I have a human interest story here from a newspaper from my State, describing the Fluffo Mop Co. of Goodlettsville, TN.

This story concerns a man and a wife who secured an SBA loan to open this company in their garage, several years ago. This company grew to a point where it employs 30 persons who produce 18,000 mops and brooms a week.

They went to a number of local banks and other local lending agencies for financial assistance to start this company and were turned down. They needed SBA's help to get started. If we abolish the agency's lending authority there would be no hope for similar entrepreneurs who might end up employing 30 taxpaying citizens in their community.

Mr. STOCKMAN. Well, I will just respond by saying that is preposterous. There is no mop shortage in this country. There may not have been a Fluffo Mop Co., but there would have been a Moppo Flop Co.

Senator SASSER. We are not talking about a mop shortage, Mr. Stockman.

Mr. STOCKMAN. The point is a lot of other people start businesses without an SBA loan. They get a bank loan. Your colleague, Senator Boschwitz, was in the lumber business and had a partner who used to be a major small business in my old congressional district. He started in his garage, too.

And now he makes cabinets, Merrillat cabinets, that are sold worldwide and are probably in your kitchen. To say that there is not going to be new business, that there are not going to be businesses that start in garages and become multimillion dollar enterprises without SBA is just nonsense.

Senator SASSER. But I think you would agree, that there will be fewer without SBA's lending authority.

You have also said that it is unfair for one businessman to have to compete against another business that gets a lower interest rate SBA loan.

Well, what of the unfairness in some of the tax proposals that Senator Bumpers has referred to? I did not hear any accusations of unfairness when we were passing Safe Harbor Leasing and accelerated depreciation; tax preferences which primarily help large firms. Such tax preferences allow companies like General Electric, for example, to pay no taxes at all. Where is the fairness in that?

Mr. STOCKMAN. Well, there is a lot of unfairness in the Tax Code. That is why we are proposing comprehensive, sweeping reform. I do not know whether we will end up with the precise package that the Treasury has proposed, but some of the concerns that you have about General Electric not paying any taxes or excessive depreciation writeoffs are addressed fairly and squarely in that proposal.

The way to correct unfairness in the tax code is to correct the tax code. That is not a justification for SBA. Besides that, the 1981 act cut tax rates by 25 percent for every individual proprietorship, individual businessman in this country, millions of them. That is the best thing that this Government has ever done for all the small businesses who pay taxes on the individual income schedule. That has long been a concern of this committee.

Rather than criticize it, we ought to realize that in one fell swoop, we did more to help small business than we possibly could do through some of these lending programs.

Senator SASSER. One final question, Mr. Chairman, that is not totally on point. Have you discussed with the President whether or not he is going to veto the farm credit bill that was passed here in the Senate yesterday?

Mr. STOCKMAN. Well, I do not think we have had the final discussion on that. He does not make any call until the bill gets to his desk. Those of us in the administration who will be giving advice have all agreed among ourselves that if that should happen, and I do not know that we will get this legislation, but if it should, we would recommend that it not be approved.

Senator SASSER. Well, you know, of course, that that farm credit legislation was passed to help a great number of small businessmen who just happen to be farmers.

The CHAIRMAN. Again, if I could, I just want to make sure that your statistics stay on target. When you are saying 95 percent of everybody that wants credit can go out there and get it without the SBA, we are talking now about 95 percent of the universe of women, blacks, Hispanics, somebody without a track record? Do you want to stick to your 95 percent that they just go out there and get a loan?

Mr. STOCKMAN. I was making a generalized statement, Senator. Plus I would further say that if women cannot get credit, all other things being equal, it is due to the fact that there is illegal discrimination and the way to solve that problem is to enforce the laws against discrimination. The same is true with blacks or Hispanics or others, if the reason that they cannot get credit is merely their gender or their color.

You have to fight a problem head on. You have to target where the barrier lies.

The CHAIRMAN. I do not want to get that. But civil rights enforcement has not been a strong suit of this administration.

Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

Mr. Stockman, the administration, the President of the United States, as I understand it, is proposing that we eliminate the Small Business Administration, is that correct?

Mr. STOCKMAN. We are proposing to eliminate the lending programs in their totality, and therefore, the field office structure that does the lending, and move the other functions that I have enumerated, procurement, advocacy, minority assistance, and so forth, into an independent agency within Commerce.

Senator LEVIN. Is the President proposing to abolish the Small Business Administration?

Mr. STOCKMAN. As an organizational entity, yes.

Senator LEVIN. Why can we not just get a straightforward answer to that question?

Mr. STOCKMAN Because it will be interpreted to mean that we are abolishing everything that SBA does, and I wanted to distinguish those activities that we are proposing to keep from those that we are proposing to terminate.

Senator LEVIN. I did not ask you about its functions. I asked you about the administration's intentions.

Mr. STOCKMAN. Well, I was——

Senator LEVIN. I know, but I want you to answer the questions that are asked, and then you can add whatever you want. The question is. Did this budget document write that the Small Business Administration will be abolished if the President's proposal is adopted?

Mr. STOCKMAN. I have indicated yes.

Senator LEVIN. Not clearly. You talked about its functions. Some of them will be preserved. Some of them will not be.

Mr. STOCKMAN. That is the proposal.

Senator LEVIN. No. The proposal also is to abolish the Small Business Administration, right?

Mr. STOCKMAN. That is correct, as an organizational entity.

Senator LEVIN. Thank you. And some of its functions?

Mr. STOCKMAN. And some of its functions.

Senator LEVIN. Including its biggest function, its loan guarantee function?

Mr. STOCKMAN. That is correct.

Senator LEVIN. Now, people who are knowledgeable about business and supporters of the free market, including the Chamber of Commerce of the United States and the National Federation of Independent Business, oppose the abolition of the Small Business Administration, is that right?

Mr. STOCKMAN. That is my understanding.

Senator LEVIN. Have you talked to them about it?

Mr. STOCKMAN. Yes; I have talked to a variety of them.

Senator LEVIN. No. Just those two organizations. Have you talked to those two?

Mr. STOCKMAN. I talked to representatives of both organizations, yes.

Senator LEVIN. So that your understanding is based on direct contact with them?

Mr. STOCKMAN. Well, I am not sure where this is going. They have--

Senator LEVIN. I know you do not. I am not sure I am either, but I am just trying to get a straight answer out of you for the moment.

Mr. STOCKMAN. Well, no, you are trying to give me leading questions.

Senator LEVIN. I will be very direct. Have you talked to the NFIB and the chamber of commerce?

Mr. STOCKMAN. Yes.

Senator LEVIN. That is not leading. That is a very straightforward question. Do they oppose the abolition of the Small Business Administration?

Mr. STOCKMAN. My understanding, and this was only informal, is that they would agree to have a number of the programs eliminated but not the agency as an organization.

Senator LEVIN. In other words, they oppose the abolition of the Small Business Administration?

Mr. STOCKMAN. As an organization, that is correct.

Senator LEVIN. Is the Small Business Administration an organization?

Mr. STOCKMAN. I think we can assume that.

Senator LEVIN. OK. Now, having assumed and established that, do those two organizations, the NFIB and the chamber of commerce, oppose the abolition of the Small Business Administration?

Mr. STOCKMAN. That is my understanding.

Senator LEVIN. Which you got directly from them?

Mr. STOCKMAN. No, I have read it, number one, and second, that was what they indicated when I talked to them.

Senator LEVIN. That is what I am saying. You got it directly from them. Why is that so hard to acknowledge that you got that directly from them?

Mr. STOCKMAN. It is not. I just think we are wasting a lot of time.

Senator LEVIN. I think there is a real arrogance in that answer, and I think the public has noted that arrogance in many other answers. Let me tell you that I think you are taking a lot of heat for this administration. I think you have been a heat shield in a lot of respects and I know you are getting tired of taking the heat, and frankly, I do not blame you.

There are farmers out there who are yelling at David Stockman, and I keep telling them that this is the administration's proposal. There are small business people out there that are yelling at David

Stockman, and I am trying to say to them that it is the administration's proposal.

I do not blame you for getting tired for taking the heat. But I do blame you for what I consider to be arrogant answers, to talk about ratholes, to talk about farmers getting plowed under by the tens of thousands as being the way a vibrant economy works.

There is not a hell of a lot of sympathy that I get out of that. So I can understand why you are getting tired of taking the heat, and frankly, I do not think you ought to take the heat for administration programs. They are administration programs.

That is why when I ask you whether the President proposed to absolish the Small Business Administration, I would have thought you would say, yes, that is the President's proposal. It is not David Stockman's proposal. It is the President proposal.

Mr. STOCKMAN. Senator, if I could respond?

Senator LEVIN. No, you cannot because I have not asked a question yet.

Mr. STOCKMAN. That is what I was hoping we could get to.

Senator LEVIN. You will get to it, but now we are on my time. You have talked a lot longer this morning than I have. My point here, my single point is that organizations knowledgeable about business, such as the NFIB and the U.S. Chamber of Commerce, which believe deeply in the free market and generally oppose government intervention therein, oppose the President's program to abolish the Small Business Administration and some of its most important functions. That is my only point, and I think you agree with that.

Now, the next question. I think that when you described the reasons for what you are doing, you are trying to have it both ways. In one sentence you say that you cannot afford it any longer. You cannot afford the SBA any longer, that it is, in your words, a luxury we can no longer afford.

On the other hand you say that this current fiscal crisis provides us an opportunity, in your words, an opportunity to dispense with an activity that serves no public mission.

Now, I think I know where you are philosophically on it. I think you basically, in principle, oppose the loan guarantee program of the Small Business Administration, from what I have heard.

Mr. STOCKMAN. Yes.

Senator LEVIN. OK. Is it not fair to say that you would, even if we had no deficit, believe that we ought to——

Mr. STOCKMAN. Yes.

Senator LEVIN. Let me finish my question. I am so delighted with the answer maybe I should not finish the question. I am delighted with the clarity of it. Even if we had no deficit, you would be in favor of abolishing that function of the Small Business Administration.

Mr. STOCKMAN. I would.

Senator LEVIN. So I do not think you ought to talk about this being a luxury we cannot afford. What you are really saying is that you oppose this in principle and that even if there were a zero deficit, that you would recommend that it be abolished. Now, that is clear.

But just do not try to use the argument that in this crisis, in this deficit crisis we have to take some actions we otherwise might not do. That is not your point. You are using this deficit crisis to get rid of something which you think we ought to get rid of, and you can be straight and candid about that.

Mr. STOCKMAN. Well, if I can just rephrase what I said, then I think we will both be in agreement. I should have said it is an inappropriate luxury and we especially cannot afford an inappropriate luxury now. That is all, but it was inappropriate at any time.

Senator LEVIN. Fine. That is fine. So the deficit is not the reason that you want to abolish this function of the SBA. The reason is that it is wrong in principle, right?

Mr. STOCKMAN. That is one compelling reason, right.

Senator LEVIN. That it is wrong in principle.

Mr. STOCKMAN. That is right.

Senator LEVIN. OK. The deficit then becomes the engine for getting rid of something which you want to get rid of anyway.

Mr. STOCKMAN. Well, it becomes the compelling reason. We tolerate a lot of things that we think may be slightly inefficient or wasteful, but if there is no compelling reason, we go along with it.

Now, we cannot afford to go along with it.

Senator LEVIN. We cannot afford to go along with something that is wasteful now?

Mr. STOCKMAN. That is right.

Senator LEVIN. But we should not go along with something that is wasteful anytime, should we?

Mr. STOCKMAN. Well, I know, but none of us are perfect, and we tolerate things that we do not like. We do not reform everything overnight, do we?

Senator LEVIN. No; I am saying that we should not go along with this in any event no matter what the times were.

Mr. STOCKMAN. In principle no, I do not think we should.

Senator LEVIN. Is that also the President's view?

Mr. STOCKMAN. I cannot say exactly what his bottom line decision calculus was. You can go at it both ways. One, you can be philosophically opposed to it and fight it all the time. Or second, on the margin you can weigh all your other choices and say, "Well, this does some good but not as much good as WIC or not as much good as defense," and so I get rid of this.

I think the President's was more a priority choice. He had to reduce the budget, and the merits at SBA were much less strong than they were elsewhere.

Senator LEVIN. But you do know whether the President opposes the loan guarantee function of the SBA——

Mr. STOCKMAN. I think he would be skeptical.

Senator LEVIN. Let me just finish, if you would. You do not know whether the President opposes the loan guarantee function of the SBA in principle?

Mr. STOCKMAN. I could not say for sure. I think he is skeptical, though.

Senator LEVIN. Now, one of the items that you have left in the budget, and by the way, before I go into this, I think the statement that you made near the beginning this morning, that the President's statement that we saw here in this television piece about small business functions of the SBA that he made during the campaign was just reading a script put into his hands by the SBA, whereas this budget document which says abolish the Small Business Administration is really his considered judgment, is one of the most illuminating statements that I have heard about this administration from anybody.

And I would hope—I would hope—that that is a focus of a lot of attention, because it should be. Again, I believe very much that you have been a heat shield, a lightning rod for the President, and you have served that function very well for the President.

I will move to another subject if I have another minute. You have left in the budget a requirement that agencies set aside some contracts for small business.

Mr. STOCKMAN. Have we? Yes. We have not proposed a change in the existing law.

Senator LEVIN. You are not proposing that we eliminate the small business set aside?

Mr. STOCKMAN. No, absolutely not.

Senator LEVIN. Is that not a Government allocation of resources, an intrusion into the free market?

Mr. STOCKMAN. Well, not in the same sense, because we are regulating the Government here as a purchaser. So it is the Government regulating itself with a view to the notion that in the past certain categories of suppliers have not been given a fair shake and we want to make sure that they do get it.

That is different than the overall private marketplace as to who gets credit and who does not.

Senator LEVIN. Is that a wasteful process, in your opinion?

Mr. STOCKMAN. No; economically it probably costs us money. As a social objective, to make sure that minority firms have a decent chance to compete, I think it is a desirable objective, and that is why we do it.

Senator LEVIN. I did not say minority firms, by the way. I said small.

Mr. STOCKMAN. Small firms, minority firms, yes.

Senator LEVIN. I specifically asked you about the small business set-aside.

Mr. STOCKMAN. All right. The small business set-aside, the answer is yes, for the same reason. When you are dealing with Pentagon bureaucracy, small business may not get a fair shake.

Senator LEVIN. So you do favor, even though we may end up paying a little more for something, setting aside contracts for small business so that they can fairly compete with big business.

Mr. STOCKMAN. Well, I am just not going to argue with it. To me, I do not feel that there is some powerful, compelling argument, but most people believe it is necessary. I have not seen any evidence to indicate it is not. So I am not going to quarrel with it. I think if all of you feel that is what we need, good.

Senator LEVIN. You do not oppose it in principle.

Mr. STOCKMAN. No, I do not oppose it in principle. No.

Senator LEVIN. I think I probably used more than my time. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Stockman, I am not going to get in an argument with you. It is a little wasteful. It does not make much sense and we both pretty much know where we stand on a lot of points that come up before this committee.

I would like to ask you a question, though, about the Disaster Loan Program within SBA. You may have different figures. Let me give you the figures I have, the total amount of disaster loans from 1953 through 1984 is about 900,000. The dollar amount is close to $12 billion for that same period. The loss rate is 3.9 percent, and between homes and bisinesses, about 700,000 of those loans were for home Disaster Loan Program and about 200,000 for businesses.

My question is, Why do you want, in addition to abolishing, the guaranteed small business loan program, also want to abolish disaster loans?

Mr. STOCKMAN. Well, because in principle I do not think it is right. People can insure themselves against disaster. If there are flood disasters, they can buy subsidized flood insurance of which several million people are buying it now. It costs them a couple hundred dollars a year.

Or for other kinds of hazards, they can buy insurance from various kinds of private companies. I think as long as we indicate we stand ready to make low interest loans available if a disaster comes, the incentive to buy insurance and thereby cover your risk, if you are in a disaster prone area, is enormously reduced.

Senator BAUCUS. So basically it is your view that there should never be any Federal disaster assistance?

Mr. STOCKMAN. Well, we have grant programs where we come in and try to clean up in the immediate aftermath of a disaster where community facilities have been disrupted or whatever. But the SBA Program provides loans to individual businesses and individual homeowners who should have insured themselves.

Senator BAUCUS. I do not want to argue with you. I want to have a discussion.

Mr. STOCKMAN. But I did not want to be misinterpreted. We have the regular FEMA Disaster Grant Program where we come in and help a community that has been hit. We are not arguing with that. We should continue to do that.

But in terms of an individual homeowners or businesses, we do not think that the Disaster Loan Program is necessary because they can get insurance.

Senator BAUCUS. If we can just make it clear that FEMA provides disaster assistance for bridges, and so forth. No assistance for businesses.

Mr. STOCKMAN. That is exactly what I am saying.

Senator BAUCUS. I understand.

Mr. STOCKMAN. The community should get aid but not individual businesses.

Senator BAUCUS. So it is your view that under no circumstances should a business receive any disaster loan assistance.

Mr. STOCKMAN. Not where it is fully capable of insuring itself.

Senator BAUCUS. What about those instances where insurance for various reasons may not be available? How about where an insurance policy does not fully cover? Or when small print or some provision in the insurance policy so the insurance company does not pay?

Mr. STOCKMAN. Well, if it could be shown that there were some big market imperfection where for various kinds of hazards and predictable disasters like earthquakes or hurricanes or floods, there were no insurance available, then you have a market imperfection. Then you can raise the question should the Government come in.

Senator BAUCUS. That is not what we are talking about here. I am just asking the question. I do not know the answer to it.

Mr. STOCKMAN. My evidence——

Senator BAUCUS. I am sorry, Mr. Stockman. Just calm down a little and do not interrupt all the time. Do not most insurance policies have escape clauses for natural disasters?

Mr. STOCKMAN. You can buy insurance to cover almost any kind of event and we sell it in the Government. We sell billions of dollar's worth of flood insurance which, if you will break down that $10 billion worth of disaster loans, has basically gone to flood situations.

We sell it so I do not have to prove that. I know we have a huge, big flood insurance sales program.

Senator BAUCUS. But that is not always available. All I am saying is sometimes the market is not totally perfect. The marketplace is not totally perfect sometimes.

Mr. STOCKMAN. That is true.

Senator BAUCUS. Thank you. If that is the case, it seems to me there is an appropriate role for Federal disaster loan assistance particularly when the loss rate is so low. Again, I could get into a longer argument with you. But, the fact of the matter is, Congress decides whether or not SBA is going to be abolished or not, and I think the Congress is going to not abolish the SBA. So we should not waste time here.

One other point I would like to make. Your title is Director of the Office of Management and Budget, is it not?

Mr. STOCKMAN. That is correct.

Senator BAUCUS. It has always intrigued me how often you are up here talking about budget issues, not management issues. In your opening statement, you talk about how waste and the deficit has to be under control, about priorities, and so forth.

You at least once today—and I have not been here the whole time—talked about the large Pentagon bureacracy, for example. I sense from the words that you chose that you think there is some waste in the Pentagon.

So my question is, instead of abolishing the SBA, why does not the Director of OMB spend more time managing the bureaucracy, that is, getting rid of some of the inefficiencies in the Pentagon, for example, instead of recommending abolishing an agency which does provide a lot of service to a lot of people.

Mr. STOCKMAN. I will tell you the answer. You cannot micromanage the Federal Government from OMB. The only thing you can do is promote policies that will make it more efficient, and we do that. I think to the extent there is waste in the Pentagon, a lot of it has to do with the explicit statutory policy that, for one reason or another, Congress has laid on it.

We would like, for instance, to be able to buy more commercial items and less military specs. But there is a clause in the law that says, for certain categories, you have to use military specifications when it is readily available for competition as a standardized commercial item.

If we could get some of those things changed, I think a great deal of what you might say is the waste over there could be eliminated. But, it apparently is not waste in everybody's eyes or they would not strongly defend policies that cause these additional expenditures to be made.

To them it is serving a desirable objective. So we argue about it. It is all a question of policy.

Senator NUNN. Would the Senator yield just on that point?

Senator BAUCUS. Sure.

Senator NUNN. Have you all proposed a change in that law in the military? Has the administration come before the Armed Services Committee and said we want it changed?

Mr. STOCKMAN. I would have to check that. I think that our procurement office has been hammering on that one for quite awhile.

Senator NUNN. Would you let me know because I would like to get the citation and so forth?

Mr. STOCKMAN. I would like to send it to you, Senator. I think you would be interested.

Senator NUNN. Thank you.

Senator BAUCUS. Senator Nunn obviously knows more about the details of defense policy than I. From my perspective, from my point of view, you could do better spending more time trying to root out some of the waste and inefficiency in the Pentagon than coming up here trying to abolish an agency which is much smaller. Sure it has some waste, but I would venture to say probably a lot less waste than in the Pentagon. So try to spend more time trying to root out the big waste and less time trying to ideologically, pursuant to your ideological libertarian points of view get rid of an agency that serves a lot of people.

Thank you, Mr. Chairman.

The CHAIRMAN. Before yielding to Senator Nunn, again, to go on the basis of the statements made in your presentation for the elimination of the Small Business Administration, you said in 1981 and 1982, only one-third of 1 percent of SBA guaranteed loans went to computer, semiconductor and pharmaceutical manufacturing industries, the cutting edge of U.S. economic growth, technological progress and job creation.

I want to underline now, watch the words you used very carefully here. In 1981-82, only one-third of 1 percent of SBA guaranteed loans went to computer, semiconductor and pharmaceutical manufacturing industries.

That would sort of lead one to believe in a broad perception that this cutting edge of U.S. economic growth had no role to play in the Small Business Administration. There is only one thing wrong with that. Specifically the Small Business Administration SBIC Program is the one that gets into this area. And as a percent of the total program relative to the industries that you mentioned, in 1981, 39 percent of the SBIC Program—the percentage is a percentage of the total program—went to these industries.

In 1982, 44 percent went to these industries, and then the period which you do not cover in your statement, 1983 was 50 percent, and in 1984, it was 52 percent. That is again the difference between the Loan Guarantee Program which is for long-term financing and SBIC Program which goes to the equity financing area. That is the area of SBA that has gone into high tech.

So again I do not want a perception left by you, Mr. Stockman, that SBA is not involved in "the cutting edge of U.S. economic growth and technological progress." It clearly is via the SBIC Program.

Would you like to comment?

Mr. STOCKMAN. I can tell you, Senator, that this analysis was based on the guaranteed and development company loans which are a large volume of about $3 billion a year. We said that very clearly in the first table. That is what I was referring to, obviously.

The CHAIRMAN. I understand, Mr. Stockman. But to the person out there listening to you—and when you talk about an SBA Program—I think it is a little bit much to expect that they are going to go ahead and differentiate between the Guaranteed Loan Program and the SBIC's and the MESBIC's, and so forth. You left them with a general perception.

I agree. You say the Guaranteed Loan Program, and maybe——

Mr. STOCKMAN. Well, I saw the piece of paper.

The CHAIRMAN. It is half a statement, Mr. Stockman. It does not include the SBIC Program which is a part of the SBA overall program. It is one of those programs, as is the Minority Enterprise Small Business Investment Company Program, which you seek to eliminate, just as you sit here and make a statement—I forgot what it was that you wanted to shift over to Commerce, something to do with minorities, minority assistance, or something of that nature.

The fact is you are seeking to eliminate the Minority Enterprise Small Business Investment Company Program. You want to do away with MESBIC's. So let us not kid ourselves as to what is being sought through your elimination proposal. It would include both the SBIC Program which is on the cutting edge of economic growth and technological progress, and the minority program that is part of these small business investment companies.

Senator Nunn.

Senator NUNN. Mr. Chairman, I had to be at several other meetings. I regret I was late. I am not going to ask questions because I do not want to retrace things that have already been brought up. I am very much concerned in this area and will try to catch up on what has occurred but I will pass at this time.

The CHAIRMAN. We have three witnesses of various businesses that are here to testify, and if anybody else has anything further to say, I have further questions that will be proposed for the record.

I might add that I invite you not only to stay. We have appearing before the committee, Dr. William Saigh who is the director of a successful restaurant in Clayton, MO. Cynthia Straus, the president of Chem-Plate Industries of Elk Grove Village, IL, and Mr. Edward Green, president and chief executive officer of Pandick Press of New York City.

None of these are banks. They represent, again, another variety of those who have been helped by various SBA programs as indeed were the handicapped programs that we heard last week, the minority magazine, black magazine, Essence.

But more importantly since you are skeptical of what it is that is going on in the outside world, I would invite you to sit right beside me and let you go ahead and fire the questions at these people vis-a-vis their involvement with the Small Business Administration, and if you would like to do that, please join us up here.

In the meantime, and subject to no further questions, there are—well, Senator Bumpers has one. I will conclude on this note. I cannot tell you what your glib remarks have done to an agency insofar as its recruitment and retention of personnel.

I know one thing. The Small Business Administration will continue in operation. If I had to hazard a guess, I would say it would be minus the Direct Loan Program to a great degree with the exception of MESBIC's, handicapped, veterans.

I would also suspect that the Disaster Loan Program as it applies to farmers and I know that Senator Bumpers is in disagreement with me on this, probably will not be retained. But it will continue in these areas that we have discussed here today.

Lord knows it is hard enough to get good people to take the lousy salaries and the long hours insofar as helping to run the Government of the United States, it is difficult enough under those circumstances without somebody at your particular rank which is just about as high as you can get disparaging an agency and indicating it is not going to be around.

I know from having talked within the agency and without you have created a hell of a personnel problem already, and I hope there is some way you can explain to people a point of view without scaring the hell out of them and getting them to pick up and leave.

Maybe philosophically you do not feel that someone that is a little bit behind needs a hand up. I do, and indeed, this program has been amazingly successful. It is everything the President said it was. It is a partnership between the Government and the private sector. The taxes paid by successful businesses, people employed, the statistics speak for themselves.

I have no difficulties with you persuing your philosophy as along as it does not hurt people, as long as it does not unnecessarily hurt people. So even though I realize that the task is going to be more difficult to administer the agency and get good people, I want to use this as an occasion for saying you are going to lose. You are going to lose, not because I got the votes but because I have the case.

The only thing, again, I would say insofar as your particular function is concerned, whatever conclusions you arrive at I would hope from now on they would be supported by very accurate fact and very precise facts.

This document, your preliminary document, your followup document is very loose figuring, indeed, and I do not think worthy of the office.

Senator Bumpers.

Senator BUMPERS. Mr. Stockman, on page 20 of your testimony where you show the so-called maturity cohorts in 4-year increments, I notice that over there where it says "defaulted loans purchased" for the first cohort it was 18.2, the next one 16.2, the next one 21.7, and now under Jim Sanders' administration, 4.7. That is a very dramatic improvement in the default rate, is it not?

Mr. STOCKMAN. Well, I would hope that there is some of that element in it. It is basically a function of the credit cycle. These are very new loans. A lot of the money has been put out in the last 18 months, and so therefore, it is too early to tell whether this is a big change in the purchase rate or whether it is just a function of the newness of the credit.

Senator BUMPERS. I think your point is well taken in that regard, but I dare say I doubt that any of the other cohorts in the same timeframe would have had a default rate that low.

Mr. STOCKMAN. I think it is better than it has been.

Senator BUMPERS. So from that standpoint, it seems like a most inappropriate time to start torpedoing people who seem to be improving the record dramatically.

Thank you, Mr. Chairman.

The CHAIRMAN. I have further questions to be submitted for response for the record by Senator Dixon of Illinois and Senator Boren of Oklahoma.

I thank you very much for your courtesy in appearing before this committee, and I suspect that we will be seeing a little more of each other as the weeks progress, and as I indicated to you, you are more than welcome to sit up here and grill those that have been beneficiaries of the SBA program.

Mr. STOCKMAN. Senator, I appreciate your invitation and the chance to come here. I did not frankly come thinking that I would convince the Small Business Committee of the case for eliminating these small business functions, but I wanted you to understand that this was not arrived at frivolously. It was not something we just threw in the budget because we wanted to save money. There is a substantial argument that can be made whether you accept it or not.

I have other things that I have to wrestle with at the present time, but I will be happy to look at all of the witnesses' testimony who submit before your committee for this round of hearings to see whether there are things that I am overlooking.

I also regret, if it is true, as you say, that I have harmed somebody, because I certainly did not intend that at all. I have simply been trying to make a case for this policy issue that arises in the budget. I know we disagree, and I hope we can leave it at that. I am sure you will do what you have to from your point of view and we will do the same.

The CHAIRMAN. Just answer me one question before you leave—which is not part of the subject here—but I could not get an answer the other day from Secretary Dole. You said this was vigorously appealed—this business with SBA. Right?

Mr. STOCKMAN. Yes.

The CHAIRMAN. Was Amtrak appealed?

Mr. STOCKMAN. Yes, I think that may have been one of the items, yes.

The CHAIRMAN. Thank you very much.

[Subsequent information was received and follows:]

LOWELL WEICKER, JR., CONN., CHAIRMAN

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 8, 1985

Mr. David A. Stockman
Director
Office of Management and Budget
Old Executive Office Building
Washington, D.C. 20503

Dear Mr. Stockman:

Attached are additional questions that the Committee would like you to respond to for the record.

Please have your responses to the Committee by March 22, 1985. Your prompt attention to this matter would be most appreciated.

Sincerely,

LOWELL WEICKER, JR.
Chairman

Enclosures (Omitted.)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 25, 1985

Mr. Bob Dotchin
Senate Small Business Committee
Washington, D.C.

Dear Bob:

Attached are the OMB responses from your February 28, 1985 hearing on FY 1986 Budget.

Thank you for the opportunity to review this material. If you have any further questions, please do not hesitate to contact us.

Sincerely,

Wendi Petsinger

Wendi Petsinger for
Fred Upton,
Assistant Director for Legislative Affairs

DAVID A. STOCKMAN

ADDITIONAL QUESTIONS FOR THE RECORD

1. Mr. Stockman, P.L. 98-276 requires the President to conduct a White House Conference on Small Business. The law states that a conference will be held in each state prior to a National Conference in September 1986. Small Businesses throughout this nation want to participate. What has the Administration done to implement this law? What does the Administration plan to do in the future to ensure that the law is implemented?

Answer: The Administration intends to ensure that the law is carried out.

2. Your proposal calls for transferring to Commerce of 732 personnel spaces and $52.9 million in salaries and expenses, and transferring to Treasury an additional 1,650 personnel spaces and $73.9 million in salaries and expenses. The savings in "overhead" spaces are quite minimal. Therefore, isn't the proposal to eliminate SBA as an independent agency within the Executive Branch simply an organizational box shuffling?

   How does the government generate any "savings" from this box shuffling?

Answer: The proposal to transfer remaining functions to the Departments of Commerce and Treasury is intended to place those activities where they can be carried out most effectively. It is not simply an organizational box shuffling and it results in significant savings in salaries, expenses, and personnel. For 1986, the savings are $43 million in budget authority and 1,838 full-time equivalents. In 1987, an additional 1,566 full-time equivalents will be eliminated and there will be a budget authority savings of $138 million.

Won't this proposed transfer of SBA functions to the Department of Commerce have the real effect of burying the voice of small business, very deeply, within a diverse departmental "holding company" that encompasses such components as the National Bureau of Standards, the Bureau of the Census, the Patent and Trademark Office, the U.S. Travel and Tourism Administration and NOAA? If not, why?

Answer: No, transferring the remaining SBA functions to the Department of Commerce will elevate the voice of small business. Small business issues will be affiliated with a cabinet level agency and the programs will be headed by an Undersecretary. Currently, as you know, small business concerns are not addressed by a cabinet-level agency.

Doesn't the very name selected for the proposed new entity -- the Enterprise Development and Opportunity Administration -- convey a strong message by the very absence of the words "small business" from its title?

Answer: We believe the name of the new organization -- Administration for Enterprise Development and Opportunity -- reflects the Administration's strong commitment to provide opportunities for small and minority enterprises to develop and flourish. We would be pleased to discuss any ideas you might have for the name of the new organization.

3. In the film shown at the hearing the President told Jim Sanders, the SBA Administrator, and the participants in his agency's SBIC program:

> "You've proven that public/private partnerships can do things that Government alone cannot accomplish. The ingenuity, perserverance [sic], and profit motive of the private sector works remarkably well with government encouragement. This is where you fit in. And it's not just money. Even more than the impressive financial assistance you've provided is the development of a reservoir of human capital."

The President concluded: "Finally, Jim Sanders, keep up the good work at SBA so that the years to come will be even better for SBIC's and the small businesses they serve."

How have the facts changed, which would lead reasonable men to agree less than a year and a half later, to adopt a proposal to abolish this program and the agency which is part of its success?

Answer: Facts haven't changed. There is nothing inconsistent with the President's previous remarks and the current proposal. The President complimented SBA employees and their ability to work with the private sector. The current proposal to establish the Administration for Enterprise Development and Opportunity (AEDO) will enhance Government encouragement of the ingenuity, perseverance, and profit motive of the private sector. The President's current proposal is only to eliminate the inefficient, ineffective credit programs. SBA's public/private partnership and development of a reservoir of human capital will be retained in AEDO.

4. Approximately 1/3 of the "budget savings" you get from your proposal to eliminate SBA would come from the sale of the SBA loan portfolio. In your original budget submission to Congress, you projected a return on this sale of 19 cents on the dollar. On a 12 billion dollar loan portfolio, that would yield a return of about 2.3 billion dollars. Based on historical collection data, SBA would collect over 80 cents on the dollar -- 9.6 billion as compared to OMB's "fire sale" of 2.3 billion dollars. By taking such action, taxpayers lose some 7.3 billion dollars. What has changed since your original budget submission which supports OMB's assertion that the sale of the SBA portfolio will yield any more than 19 cents on the dollar?

Answer: The numbers in the budget and in my testimony are conservative estimates of what the receipts from the sale might be. The taxpayers will not lose money on the sale because the market will not pay less than the actual worth of the assets, and SBA cannot collect any more than the actual worth of the assets.

Further, it is not sufficient to merely compare what SBA would collect on the loans with what the Government would receive from selling the loans. The Government incurs many costs that are not reflected in the SBA collection rates. Most significant is the cost to the taxpayer of financing below market interest rates for periods of 10 years or more.

Has OMB obtained any "quotes" or documentation from sellers of commercial paper in the market regarding receipts that can be anticipated from the proposed sale of this portfolio? If so, please supply this information to the Committee.

Answer: No, the budget reflects a conservative estimate of receipts based on average interest rates in the portfolio, and historic loss rates on the various types of loans.

5. Were you aware of the findings of GAO report to Congress dated April 1983 entitled "SBA's 7(a) Loan Guarantee Program - An Assessment of its Role in the Financial Market" prior to your testimony before the Committee on February 28th? In that report GAO concluded that "approximately 30 to 40 percent of the dollar amount of banks' long-term financing (6 or more years) to small businesses may carry an SBA guarantee..." They cite this finding as "a measure of the value of the SBA guarantee program that contrasts with the Administration's statement that less than 1 percent of small businesses are served by the program." GAO reached this conclusion based upon their analysis that for the past 50 years small businesses have had difficulty obtaining long-term financing, and that those problems continue to exist.

Answer: I was aware of the findings of the GAO report on the 7(a) Loan Guarantee Program prior to my testimony before the committee on Feburary 28th.

Do you disagree with GAO's analysis? If so, what do you base it on?

Answer: I do not agree with GAO's analysis. GAO limited its survey to those banks that deal with SBA. Those banks would obviously have a bias toward providing SBA guaranteed financing. All of the other banks provide long-term financing without SBA guarantees.

Have you done a similar analysis or study of the ability of small businesses to obtain long-term financing? If so, please provide a copy to the Committee.

Answer: Using Federal Reserve Board data, we did a comparison of SBA loans and long-term, small (less than $500,000) commercial bank loans. We found that for 1984, SBA provided 1.5% of all long-term commercial bank loans and 8% of the dollar amount. For 1983, the percentages were 1.3% and 6.4%. In 1982, they were 1.3% and 5.7%; and in 1981, 2.8% and 10.6%.

6. Let's look at some of the other SBA programs through which SBA provides vital assistance to the small business community.

Do you consider the 2 billion dollars in equity capital to 70,000 firms creating 250,000 jobs by the SBIC program to be a bad government investment? If so, why?

With regard to the 1.4 billion dollars in economic development projects and 100,000 jobs created through the 503 program since 1980 - don't you think the government has gotten a substantial return on its investment through this program which is now the government's major economic development program? If not, please explain.

Answer: It is a fact that both the SBIC and 503 development company programs fund projects and investments that produce jobs. If they did not, the programs would amount to pure fraud. However, absent these programs, it is probable that as many if not more jobs would be created through the use of an efficient free market system, rather than through risk reducing government guarantees that distort the allocation of credit.

As I'm sure you are aware, a substantial number of small businesses fail because of lack of management experience. Since 1979 SBA has trained and counseled over 3 million small businessmen and women. Do you consider this to be an insignificant impact on the small businesses of this country?

Answer: A count of the number of people that have some contact with SBA's management assistance programs does not provide sufficient justification for the programs' existence. Management and technical assistance are provided through a number of outlets including adult education, private and public schools, and private management consulting firms and services. These are more effective and appropriate sources through which small businesses can obtain the assistnace they need. In fact, the National Federation of Independent Business recommends eliminating SBA's largest management assistance program (SBDCs) and supports most strongly the program that the Administration proposes to retain and transfer to the Department of Commerce (SCORE/ACE).

Since 1953 SBA has provided 12 billion dollars in assistance to over 900,000 disaster victims around the country, to both businesses and homeowners. Your proposal would totally eliminate assistance to these victims of floods, hurricanes and other natural disasters at their time of greatest need. What is the Administration's basis for this proposal?

Answer: The basis for the Administration's proposal to eliminate the disaster loan program is that people should insure themselves against disasters, not rely on Government loans. Private and Government insurance is available. Moreover, as long as the Government indicates it stands ready to make low interest loans available if a disaster occurs, the incentive to buy insurance, and thereby cover risk if in a disaster prone area, is enormously reduced.

As of December 1, 1984, SBA had guaranteed over 165,000 surety bonds having a value of $12.8 billion. Of this amount, SBA experienced a net loss on defaulted claims of only 1.5%. 72% of all guaranteed surety bonds were for competitively bid contracts awarded in the last eight years by federal, state, and local governments. The "bid spread" or average difference between these winning, guaranteed bids and the next highest bid was 11.7%. This translates into $917 million in savings to those respective governments. Do you agree or disagree with these findings demonstrating an overall benefit to the economy of $917 million? Please explain.

Answer: The $917 million in savings to Federal, state, and local governments can not be solely attributed to the surety bond guarantee program. The bid spread is the result of many factors (e.g., efficiency, productivity, cost of labor and material), one of which might be that the lowest bidder has a guaranteed surety bond. However, all of the factors contribute to the savings. Incidently, the information we have from SBA indicates that the bid spread results in $503 million in savings to Federal, state, and local governments, not $917 million.

7. As part of your budget submission to Congress, you state that SBA loan subsidies go mostly to economic strap hangers, weak businesses who get repeat SBA loans." You state that SBA's repeat borrowers in 1982 were 53% and that for the first half of 1983 SBA repeat borrowers were 77%. In fact, SBA repeat borrower statistics were as follows:

   o 14.4 percent of 1982 SBA borrowers were repeat customers

   o 16.4 percent of 1983 SBA borrowers were repeat customers

   o 13 percent of 1984 SBA borrowers were repeat customers

   Where did you get the original statistics submitted to Congress? Was any attempt made to verify or check these statistics prior to the time they were submitted?

Answer: The original statistics on repeat borrowers were given to OMB by SBA. SBA provided OMB with a computer printout. We assumed that the underlying computer program was properly written and that SBA's loan data base was accurate. As a result of the discrepency we now review more carefully all information that we receive from SBA. We suggest that you do the same, given that there is a discrepency in the numbers on the surety bond program provided in the previous question.

8. You indicate that the surge of private venture capital due to tax reforms and incentives is a far more appropriate and effective source of small business investment funds than through the SBA 7(a) guaranteed lending program. Are you suggesting that equity financing through venture capital funds is a substitute for debt financing? If so, please explain.

The Executive Director of the National Venture Capital Association (NVCA) has advised me that his membership, which represents 71% of the total venture capital funds available to the U.S., only financed 973 businesses in 1983. How is this a substitute for long term debt financing needed by small businesses?

Enclosed is a copy of a letter I received from the firm of Hambrecht and Quist, San Francisco, California, which is one of the nation's leading venture capital firms. This expert firm in the venture capital field is clearly saying that venture capital firms are not interested in, and will not, fill the void left by terminating the SBA guarantee program. How do you respond to his comments? (SEE EXHIBIT I)

Answer: We are not suggesting that equity financing through venture capital funds is a substitute for debt financing as provided by SBA's guaranteed loan program. Rather, we are suggesting that private venture capital is a substitute for SBA's investment company programs. There is sufficient availability of private sector debt financing and equity through banks, venture capital and other private sources of funds. The private sector can more efficiently allocate these funds than the Government.

Your budget submission chart is misleading in that it seems to indicate that in 1983, 12.1 billion dollars of venture capital was invested in this country. Although there may have been a total venture capital fund of $12.1 billion invested at that time, according to the Venture Capital Journal only 2.8 billion dollars was actually invested by venture capitalists in 1983. Do you agree or disagree?

Answer: The intent of the chart on venture capital was to indicate the rapid growth in venture capital investment over time, not the investment in any one year. I cannot confirm the 1983 investment figure, but I have no reason to assume $2.8 billion is not accurate.

Even though you argue that venture capitalists can fill the void created by the elimination of SBA, you neglect to consider that your proposal would cut over 20% of the available venture capital dollars by eliminating the SBIC program. Don't you find those two proposals somewhat inconsistent?

Answer: There is no inconsistency. The elimination of SBA will not create a void. It will lead to a reallocation of credit funds to other businesses. This will result in increased economic growth because it will remove the market distortion created by Government involvement.

You denigrate the 7(a) guaranteed loan program by criticizing it for not investing in high-tech firms which are on the cutting edge of economic growth. You state that in 1981-82, only 1/3 of 1% of SBA guaranteed loans went to high-tech firms. This statement shows a complete misunderstanding of the purpose of the guaranteed loan program, which is designed to provide long term debt financing and not equity financing. No particular businesses in the small business community are targeted for assistance in the 7(a) guarantee loan program. Those decisions are made by banks. However, the SBIC program has assisted high-tech small companies requiring equity financing in a substantial way. Are you aware of the following percentage of SIC activity during the last four years that went to high-tech small firms?

1981 - 39%
1982 - 44%
1983 - 50%
1984 - 52%

Do you consider these statistics meaningful or insignificant? Please explain.

Answer: The information that we have indicates that the following percentages of SBIC activity went to high-tech small firms:

1983 - 29%
1984 - 27%

We do not consider slightly over one-quarter of SBIC activity in high-tech firms to be significant, especially when most private venture capital activity is in high-tech firms.

Furthermore, OMB's proposal would eliminate funding for SBIC's and MESBIC's which account for over 20% of the venture capital funds invested in this nation. What do you see as the impact in this rather significant cutback in the availability of venture capital funds provided through these programs if they are terminated?

Answer: The impact of terminating the SBIC and MESBIC programs would be positive. It would result in a more efficient allocation of credit resources and thereby enhance economic growth.

The Committee heard testimony from John Carlson, Executive V.P. of Cray Research, Inc. of Minneapolis, Minnesota. As you know, Cray Research is one of the leading suppliers and developers of super computers in the world today. Mr. Carlson said that without SBIC financing, Cray Research would not exist today. He also said that the financial and management assistance provided by the SBIC were critical to his company's survival. In 1984 his company paid over $20 million in taxes and expects to pay far in excess of $20 million in taxes this year. Two years of taxes paid by Cray to the government far exceed the total losses in the 25 year history of the SBIC program. Given these facts, what economic, or any other kind of justification, do you have to support eliminating this program?

Answer: The fact that Cray Research, Inc. pays taxes is not a justification for the SBIC program. The justification for eliminating the program is that the program distorts investment decisions. Taxes would still be paid without the program and the economy would be better served.

EXHIBIT I

HAMBRECHT & QUIST
INVESTMENT BANKERS

235 MONTGOMERY STREET
SAN FRANCISCO, CALIFORNIA 94104
415-986-5500
CABLE: HAMQUIST
TELEX: 278308 HQ (RCA)

February 26, 1985

Honorable Lowell Weicker
Chairman - Senate Small Business
Committee
U.S. Senate
Washington D.C. 20510

Dear Mr. Chairman:

I am writing to express my concern with the Administration's proposal to eliminate the credit programs of the Small Business Administration (SBA).

Hambrecht & Quist is one of the Nation's leading venture capital firms. We see financing proposals from all types of small businesses on a regular basis. As venture capitalists, we are constantly looking for equity investments that will yield five to ten times our original investment within a five year period. For this type of transaction with the potential for spectacular capital appreciation, there is plenty of venture capital available.

My concern and my reason for writing this letter is the availability of capital for those firms whose proposed financings do not appear to offer such significant capital appreciation. These firms are a vital part of our National economy and provide jobs for thousands, yet, their financing needs do not justify the use of a public offering. These firms turn to their local lender for long term debt.

The SBA loan guaranty program provides the right mix of government involvement in a private sector activity to make financing available for these businesses. The government involvement encourages lenders to use longer terms than they would ordinarily consider. This term lending allows businesses to grow and prosper without the financial burden caused by short term financing.

The Small Business Investment Company Program has been instrumental in financing many successful businesses. The SBIC program can be used to fund firms with less spectacular growth prospects than firms that receive straight venture financing but have the potential for long steady growth. These are frequently middle market firms supplying input material for further processing by large companies as well as providing thousands of jobs in their communities.

Thank you for the opportunity to comment on these important programs.

Sincerely,

William R. Hambrecht

ADDITIONAL QUESTIONS FOR THE RECORD FROM SENATOR BOREN

1. Why do you feel the Federal Government should sell off the loan portfolio of the SBA when the best we could receive would be 20 cents on the dollar?

Answer: We do not know exactly how much the Government will receive for selling off the loan portfolio. We do know, however, that the market will not pay less than the actual worth of the assets. Thus, by selling the loan portfolio, the Government would receive a market-determined price that reflects the actual worth of the assets and also saves the cost of servicing the portfolio.

2. Mr. Stockman, when OMB is calculating the cost to the Government of the Small Business Administration, do you expense the loans made and/or guaranteed by SBA? Or do you figure into your calculations the fact that SBA collects at a bare minimum 76 cents on every dollar loaned? And do you add to that the fact that every dollar loaned is generating a significant amount of payroll taxes?

Answer: The Budget document does not expense the loans made and/or guaranteed by SBA. I attempted to do this for the guaranteed loan program on pages 19-21 of my testimony. Each $3 billion in guaranteed loans will cost the Treasury $300-400 million in losses excluding the interest cost of carrying repurchased loans not in current payment status (over $1 billion at the present time). We do not take into account payroll taxes. However, if we did it may add to the cost of the program. The existence of the guarantee distorts the credit market by allocating credit to less efficient and productive borrowers. The result of this distortion may be fewer jobs, and less payroll taxes, than if the distortion had not been created through the provision of Government-guaranteed credit.

3. Mr. Stockman, during the Memorial Day weekend last year (1984) my constituents in and around Tulsa, Oklahoma, suffered through two devastating days of flooding and tornados. Over 5,400 Oklahomans suffered losses in excess of $31 million. Mr. Stockman, if you abolish the SBA, who is going to be able to provide the emergency relief that is so necessary in these situations? Are we to tell our constituents that in order to reduce the deficit by less than 1% they will have to do without timely disaster relief? ($185 billion deficit reduced by $700 million annual SBA appropriation)

Answer: Timely disaster relief is available, and will remain available even if SBA is eliminated, but in the form of insurance, not subsidized Government loans. It is more efficient for all Americans, including your constituents, if people insure themselves against disasters through private and Government insurance.

Incidently, the President's budget proposal on SBA is estimated to reduce the deficit by $1.5 billion in 1986 ($5.3 billion over three years), not $700 million.

ADDITIONAL QUESTIONS FOR THE RECORD FROM SENATOR DIXON

1. The Administration proposes to eliminate a number of SBA functions and transfer some SBA functions to the Commerce Department. How is a small businessman supposed to know that there is a small business agency when the office does not even include small business in its name?

Answer: The Administration for Enterprise Development and Opportunity will have high visibility in the small business community, so a creative, entrepreneurial small businessman should be able to find it. We would be pleased to talk with you about other names for the organization if you believe there is something more appropriate to call it.

2. By placing small business in a huge department such as Commerce, is there not inevitably going to be constant conflicts of interest between the needs of small and large businesses? Won't the needs of small business lose such battles? How likely is it that a small businessman will find a truly small business representative within the Department of Commerce?

Answer: The Department of Commerce has a number of programs that are targetted to small business. The programs to be transferred from SBA will complement this effort. Small business interests will be represented by a high-level official -- an Undersecretary -- and small business advocacy will be a very important function of the new organization and the Department.

3. Isn't the Administration aware that there is precedent for the ineffectiveness of putting small business advocates within a large unrelated department in the Defense Department's Office of Small and Disadvantaged Business Utilization specialists? Why would a small business representative in the Department of Commerce be any more effective than the Defense Department's equivalent version?

Answer: The Department of Commerce is not unrelated to small business. It represents all business -- small and large. Under the President's proposal, DOC will specifically be charged with representing small business. This is not a mission of the Department of Defense. Therefore, you cannot presume that the situation in DOD will be duplicated in Commerce.

4. What is the Administration's policy upon competition within the defense industry?

Answer: The Administration supports competition within the defense industry as it does all industries.

5. Does the Administration believe that competition in defense should include small businesses as well as large businesses?

Answer: Yes.

6. Isn't the Administration aware of the tremendous difficulties which small business faces in trying to compete in the defense procurement process?

Answer: Yes. That is why we are retaining the small business procurement programs.

7. The Administration proposal eliminates the field offices of the SBA. Where does the Administration think that a small businessman is going to find someone to help him break into the procurement system when the field offices are eliminated? How will he know to call an obscure office in Commerce which does not even bear the name of small business?

Answer: The abolition of SBA does not necessarily mean the procurement field offices will be eliminated. The Department of Commerce is evaluating the most effective way to administer the procurement programs. The program activities and not the name of the organization will provide the visibility needed for small businesses to know where to call.

8. Is the Administration aware of how the small business subcontracting network presently works? The breakout representative works closely wtih the field offices in order to find small businesses to bid on transactions. Who is the breakout representative and the small businessman going to work with in the field in the absence of field offices? Who will coordinate with state and local agencies?

Answer: As indicated in response to the previous question, no decision has been made to eliminate the procurement field offices.

9. Does the Administration believe that small business does not need an advocate which is capable of being effective?

Answer: The Administration believes there should be a strong small business voice and advocate in the Executive branch. That is why the President's Budget proposes to put this function in an organization that is headed by an Undersecretary and affiliated with a cabinet-level department.

ADDITIONAL QUESTIONS FOR THE RECORD FROM SENATOR BUMPERS

1. Some small businessmen and women have indicated that the interest rate on 7(a) guarantee programs loans is now about 2% above the prime interest rate. Is that your idea of a subsidized or below-market interest rate at 13%.

   Do you think that's too cheap? Of course, the borrower also pays a 1% guarantee fee in addition, so it is almost like an additional percentage point in interest on top of that, isn't it? How much do you think these businesses should pay?

Answer: The loans are subsidized to the extent that the small businesses would pay higher interest rates without the SBA guarantee. The subsidy is the difference between the interest rates with and without the guarantee.

I think the businesses should pay what the market determines a reasonable rate is, taking into account risk and other factors, and that free-market rate can only be determined when there is no Federal guarantee.

2. Do you have any estimate of the cost of the new low-profile adminstration which you proposed to create in the Commerce Department?

Answer: The President's budget requests $53 million for 1986 to fund the new independent, high-level Adminisration in the Department of Commerce. This is the same level of funding that was provided for these programs in 1985 with additional funding for the breakout procurement center representatives.

3. Your calculations or estimates for the sale of the portfolio have changed substantially from an anticipated 19.3% in the budget passback document to 32% of face value in your testimony. You originally estimated a return to the Treasury of $2.3 billion on a $12 billion portfolio, and now you say it is anywhere from $1.9 billion to $3.1 billion. How do you account for this?

Answer: The original estimate in the budget was very conservative. In my testimony I attempted to present a range of estimates based on different assumptions. Again, these are all estimates. We are not offering to sell the assets for any particular price. The market will determine the value of the loans and I believe the market works efficiently. The Government will receive what the loans are worth, which is what SBA collects.

The CHAIRMAN. I want to thank our next witnesses for their courtesy in staying here through this portion of the testimony. They are Dr. William Saigh, director of Lettuce Leaf, Inc., of Clayton, MO; Ms. Cynthia L. Straus, president of Chem-Plat Industries of Elk Grove Village, IL; and Mr. Edward G. Green, president and chief executive officer of Pandick Press, New York, NY.

If these witnesses will please come to the table, I would appreciate it. There will be one more witness to follow who will be the Administrator of the Small Business Administration, James Sanders.

Thank you for being with us and let us get right down to your testimony.

Dr. Saigh, why do we not start in the order that the witnesses appear on the list here with you, and then Ms. Straus and then Mr. Green.

Your statements in their entirety will be placed in the record. So proceed in any way that you deem fit to tell your story.

STATEMENTS OF DR. WILLIAM SAIGH, DIRECTOR, LETTUCE LEAF, INC., CLAYTON, MO; CYNTHIA L. STRAUS, PRESIDENT, CHEM-PLATE INDUSTRIES, INC. AND BOARD MEMBER OF CHICAGO METAL FINISHERS INSTITUTE, ELK GROVE, IL; AND EDWARD G. GREEN, PRESIDENT, CHIEF EXECUTIVE OFFICER, PANDICK PRESS, INC., NEW YORK, NY

Dr. SAIGH. Thank you very much for the privilege. The Lettuce Leaf Restaurants are 8½ years old. The first restaurant was established on a $50,000 direct loan from the Small Business Administration after a futile 5-month search of 17 restaurants to participate in a guaranteed loan. Also, before we obtained the direct loan, it was another month of numerous meetings at the offices of the SBA with rigorous and grueling question and answer sessions.

The first Lettuce Leaf opened in September 1976 with 40 employees, 60 percent of whom were part timers, and it grossed $453,000 in its first year. Since then it has grown to five restaurants in St. Louis and Kansas City with 325 employees and our projections of sales for 1985 are $4.2 million.

The Lettuce Leaf pays its Federal, State, county, city and Social Security taxes religiously in addition to its interest on its loan from Boatman's Bank at 2 percent above prime that is now an SBA participating loan. This came about from the necessity to refinance for expansion purposes and from my desire to have all my eggs in one basket. The SBA guarantees one-half of this $1 million loan, a 7-year loan, and this demonstrates, I think, to this committee that I have no particular axe to grind here. I have my money and I am running with it.

Our employees pay taxes, Social Security. They save and they spend their money as consumers. We have made it a policy, also, to hire the handicapped. We have 15 to 17 hearing and speech impaired people and mentally slow young men and women working for us. A number of these, as a direct result of their earning power independence now, have left institutions and are making it on their own which we are very proud of.

I am a very small voice here, but I am here because, as a university professor for 21 years, I praised the virtues of entrepreneurship and independence, the exercise of ones mind and imagination, the use of ones innovative prowess and ultimately the glorious results of character building as opposed to working as a nonperson for a large corporation.

The SBA serves small business today—I would like to stress this point—in the same way that small banks served small business 60 years ago. That is, getting to know the loan seeker as an individual, carefully evaluating his or her project and encouraging innovation by participating in the risk.

Today you have large banks fulfilling the needs and activities of large businesses and neither of these banks nor venture capitalists are going to provide financing for the wild-eyed dreamer, the innovator nor the maverick inventor. Never ever will they do that. For both of these types of investors, one must provide proof of success before the fact which is impossible to provide on a new or innovative idea. I walked into these 17 banks and I said I wanted to open a restaurant, and they laughed. I said it was going to be a restaurant that no one had attempted before in the industry, an entree dinner salad restraurant where all the 16 to 20 salads would be on display to help the guest decide upon the salad they wished to select. They, the bank officers, were hysterical.

Without the SBA, the under collatoralized budding entrepreneur has nowhere to turn. The banks want no part of him or her, and if they are acceptable to venture capital sources, they want a piece of your tail and your midsection, too.

Unfortunately, innovation is the stepchild of necessity, a stress situation or desperation. True innovation can rarely be fostered from some deliberative thought process. Having read Waterman and Peters "In Search of Excellence," a number of large corporations, IBM, NCR, Memorex, and so forth, are attempting to subsidize entrepreneurship and innovation. They call it intrepreneurship. But it will never ever resemble entrepreneurship in any way. If you are interested in why this cannot be achieved by the large corporation, I would like you to refer to marketing innovations by Theodor Levitt from Harvard. However, the guy in charge of the intrepreneurship subsidiary of a large corporation locks the door in the evening to the shop and he goes home. An entrepreneur can never escape his/her constant concern for the business until he or she sells or dies. He/she eats, sleeps it, talks about it, et cetera, et cetera.

From an article entitled, "Let A Thousand Flowers Bloom," Eugene Lindeon, Inc. magazine, April 1984, says:

> In the midst of this celebratory din, it is possible to overlook the extraordinary nature of these events. After all, big business and small entrepreneurial companies are not natural allies. They are more like natural enemies and 80 years of distrust and misunderstanding cannot easily be erased. Moreover, not everyone is an entrepreneur nor is every giant company easily rendered into small autonomous subgroups or units. There is indeed some question about whether a major company can ever become truly entrepreneurial.

And that is the truth.

Mr. David Stockman is saying that recipients of subsidized financing ultimately injure those small businesses that are already functioning. Mr. Stockman is a very bright young man who wields a very mean pencil and manipulates numbers. He is in an appointive office. He is paid to justify what his number suggest, and this is the only justification that I can think of unless Mr. Stockman does not believe in the free enterprise system or if he has never been in a position so many of us find ourselves. Numbers are inert. People, on the other hand, are dynamic, and Mr. Stockman should get in touch with them before he makes those kinds of statements.

If this administration so desperately wants this economy to flourish to help it in its struggle to lower the deficit, then it seems foolish to shut the door in the face of the under collatorilized innovators of this country. You need no reminder to realize that the constant influx of small businesses and the innovative changes they bring with them is the chemistry that made this Nation great in the first place. Every large business was a small business at one time or another.

One additional point I would like to make is that this administration seems hell-bent on putting the independent restauranteur out of business. Last year we had tip reporting to which only the independent restaurants are subject. You do not tip employees at a giant fastfood chain. This year legislators are talking about curtailing and limiting business lunches, and once again, you do not present a Diners Club Card at the giant fastfood restaurant. It hurts only the independent restauranteur, and now they want to kill the SBA which will injure hundreds of thousands of your constituents. It will injure employment and small business's contribution in taxes and in many ways create stagnation in our present economy as a lack of innovation stagnates the large corporation because they are not receptive to it.

Restaurants account for 5 percent of the GNP. In 1984, they grossed and paid taxes on $162.8 billion; 558,000 food service outlets employ 8 million people. And do you want to know something? It is the toughest damned business in American restaurants to survive in. I hope that no one makes it any tougher.

Since the SBA relies heavily upon a bank's endorsement of a borrower and his ideas, I would also urge you to reconsider the total abandonment of the direct loan program unless it can be replaced with more flexibility in the participating loan program.

The Lettuce Leaf had its participating loan typically with a small bank City Bank, C-i-t-y not Ci-t-i, assets $50 million. Its chairman, president, executive vice president have their offices on the ground level which was neat. They would jump out from behind their desks and greet you in the lobby where you were depositing, converse with you about your business. People from the SBA St. Louis do much the same thing when they visit the restaurant.

In the period of 1 year City Bank, assets $50 million, was absorbed by Charter Bank of Kansas City, assets $2.5 billion. Its officers moved to the fifth floor. A few months later Charter was absorbed by Boatman's Bank, assets now $6 billion plus, and the officers moved downtown. There is no longer the extreme friendly atmosphere.

In any event, I sincerely pray that you deliberate long and hard and in a partisan manner about preserving the SBA for the large number and types of persons who will never otherwise be creditworthy.

One brilliant idea I think you should retain, one creative life and energy preserving innovation is worth two or three failures.

Thank you very much for your time and the privilege to appear here.

The **Chairman**. Thank you very much, Dr. Saigh, for a very eloquent statement.

Ms. Straus.

Ms. **Straus**. Hello. I am Cynthia Straus, president of Chem-Plate Industries, and in David Stockman's words I am an economic straphanger because I have been to the SBA two different times.

We started our business in 1979 with a $60,000 90-percent guaranteed loan from the SBA. We had one employee at that time. We were using innovative technology in the zinc plating business which allowed us to successfully compete with businesses that had been established for two or three generations.

We grew very quickly and paid off our SBA loan in the period of 1 year and acquired another business which would have closed down had we not bought it. Today we employe 52 people. Most of the people whom we employ had been unemployed for a period of 1 to 2 years prior to coming to work for Chem-Plate. So these, indeed, are jobs that would not exist were it not for the help of the SBA.

I think that this is the most important point—jobs. You cannot create wealth without creating jobs, and jobs are what return taxes to the Government.

We recently wanted to go into a major expansion of our company by investing in heat-treating equipment. Heat-treating equipment requires a substantial capital investment with a slow rate of return for the first 5 years. Therefore, in order to borrow money, banks, leasing companies, other types of financing institutions want to charge a very high interest rate for 3 to 5 years.

The installation is so costly that we could not afford to begin making debt payments right away on these loans. The only source of funds that we had were through the 503: a Loan Program, and they have participated in arranging 15-year financing on a substantial portion of the $1,200,000 that we need to expand our business.

This expansion will take a $4 million company to about a $7 or $8 million company within the next 18 months. Again, it will provide new jobs. We will be returning not only corporate income taxes to the Government but, of course, all the payroll taxes of our employees and their savings will also be returned to the economy.

I wanted to come and tell our story because so many people have the idea that manufacturers in the old industries are not using the SBA, and we are definitely an exception to this. We went into an industry where technology had not been implemented and were able to bring a new technology, compete on a very favorable basis, install the proper pollution equipment and meet all the new local and OSHA requirements which we are very proud to say that we have done, and some of the older businesses just do not have the capability of doing this with the second and third generation people.

We have worked very hard to be a successful company, and every loan that we have obtained we personally guaranteed ourselves, and we have put in the 70 and 80 and God knows how many hours per week to build it so we are not economic straphangers even though we have been back to the SBA a second time to obtain financing that was not otherwise available to us in order for our business to continue growing and employing the people that we employ.

I want to thank you for the opportunity to appear here. I was going to present a few statistics and things like that, but I think we have done enough of all of that and you are aware of that information yourselves.

So thank you once again.

[The prepared statement of Ms. Straus follows:]

TESTIMONY OF

CYNTHIA L. STRAUS

PRESIDENT

CHEM-PLATE INDUSTRIES, INC.

AND BOARD MEMBER OF

CHICAGO METAL FINISHERS INSTITUTE

BEFORE THE

SENATE COMMITTEE ON SMALL BUSINESS

FEBRUARY 28, 1985

Mr. Chairman, members of the committee:

As an active member of the Chicago, Illinois, business community, I appreciate this opportunity to present testimony to the Senate Committee on Small Business.

I am Cynthia Straus, President of Chem-Plate Industries, Inc., which is located in Elk Grove Village, Illinois (just outside of Chicago). I am a board member of the Chicago Metal Finishers Institute, and my statement has the support of the board. I am also a member of the Small Manufacturer's Action Council of the Illinois Manufacturer's Association, a member of National Association of Female Executives, American Electroplater's Society, American Society for Metals, National Right to Work Committee, and several other orginizations.

My company is involved in the job shop metal finishing industry which is comprised mainly of small businesses. If you will refer to the testimony of David G. Kelly, President of the National Association of Metal Finishers, you will find a more detailed discription of my industry.

I would like to take this opportunity to describe how the Small Business Administration is responsible for the existence and expansion of my company.

In 1978, one of my business partners was selling a new type of zinc plating technology. He was having a difficult time convincing the industry to try the new technology. Since we all three had some experience in the industry and believed in the new technology, we put together our ideas for a new business and went to several banks to obtain financing. At that time, the economy was in a downturn and several banks rejected our requests. We found a banker who was willing to work with us on the condition the SBA would participate by guaranteeing our loan, the proceeds of which would be used to purchase capital equipment.

We contributed $20,000 of our own capital, signed personal guarantees and borrowed $60,000 which was 90% guaranteed by the SBA. We started our business March 1, 1979 with 1 employee. We were profitable our first year in business, and, as a result, a year later we paid off our SBA guaranteed loan and acquired an existing business which was about to close down.

Without the initial help of the SBA we never would have been able to start our business which now employs 52 people and has sales of $4,000,000/year. In 1984 alone our annual net pay was $807,450, federal withholding was $161,200, employer FICA contributions were $56,000 and annual state withholding was $23,400.

I have disclosed this information so that you could see a guaranteed loan which did not cost the government any money other than for administration (most of which was done by the participating bank) was more than repaid by the taxes collected from one year of our payroll.

These jobs, which contribute to the tax base, would not exist today were it not for the assistance we received from the SBA in 1979.

In 1984 we decided to make a major capital investment into our company by installing two heat-treating furnaces. Heat-treating is a highly capital intensive industry, and, as a result, the return on investment takes time. We discussed the idea with our bank and leasing companies, and the best terms offered were for high-cost 5 to 7 year loans. The initial start-up is so costly that we had to find a longer term source of funds. The only source of long-term funds was, once again, the SBA.

Our bank contacted Greater Metropolitan Development Corporation (GMCDC) and together they put together a 503A loan package for my company. Administratively, the SBA did no work other than to approve the package at a loan committee meeting. We were able to receive 15-year financing for a large portion of the $1,200,000 needed to purchase capital equipment which will add up to 15 new jobs and increase our sales from $4,000,000/year to $7,000,000/year. This increase in sales and personnel will once again generate more than enough revenues in the forms of payroll and corporate income taxes to repay the government for its time and effort.

Without the 503A loan program Chem-Plate would not have been able to afford to attempt this major expansion. We had no other competive, long-term source of funds available.

I have spoken with many small business people and they consider the SBA an important source for long-term capital investments. Unfortunately, in the manufacturing industries, the SBA has not been as effective as it should be. However, with the new 503A program, the default rate is much lower. Janice Mullin, of GMCDC, tells me that the 503A loan programs are being used by GMCDC almost exclusively for manufacturing types of companies who need to make large capital investments. The failure rate on these types of loans is very low because professionals of the lending institutions are doing the decision making rather than employees of the SBA who have no experience in lending decisions.

In discussing whether or not to abolish the SBA we have to keep in mind the concept that wealth is created only one way: by jobs. For a company to grow and expand it needs capital. By providing capital for investment the SBA creates jobs. When people work, they pay taxes, which in turn provides the government a financial base for providing services to the people it governs.

When we analyze the "cost" of the SBA we must include the taxes which are sent to the government by the people working in the jobs "retained or created" by the companies which take the risk of expanding and employing these people.

I say "take the risk" because even though one has help it is still a risk. All the SBA loans require personal guarantees and if the business does not succeed, the owner still has a lot at stake.

Other governments, such as Japan, help their businesses by providing funds for establishment and expansion. Since small business in the U.S.A. employs over 50% of the working people and creates over 70% of the new jobs, it should receive some limited support from the government. If you subtract out the direct loan programs and consider only the guaranteed and the 503A loans, the SBA is not involved in a give-away project. The companies which receive funds in this way have an excellent record of repaying not only the loans, but of returning wealth in the form of taxes to the government.

Other individuals and groups share my opinion. Mr. Robert G. Heard of the Coalition of Small Business Advocates has commented on several myths about the SBA in his editorial published in Crain's Chicago Business (2-25-85), copy of which is attached.

Small business has earned its keep. We are the conductors on the train travelling to America's future. We are not nascent; we have collectively evolved into the sustainers of the American workforce. Small business is, and will continue to be, the guardian of our country's creative resources and prosperity.

Since the government has been dedicated to overspending by borrowing most of our country's capital for its own expenditures, there is a real need for the SBA. We are not asking to be mollycoddled. Lend us a hand and we will pay our own way. Until such time that the government balances its budget (as business must do on a monthly basis) and makes its borrowed capital available to business (or citizens), its debt is greater than merely the money it borrows: the government also "owes" the people who need jobs. The government must assist in making some funds available to small business so we can accomplish the tasks at hand---producing goods, services, and most importantly wealth.

Cynthia Straus, President
Chem-Plate Industries, Inc.
(a successful, growing, and
profitable small business
enterprise thanks to the
support of the SBA.)

Destroying myths reveals importance of SBA's role

By ROBERT G. HEARD

Your Turn

Illustration by Derek Parks-Carter

Do you know anything about these companies:

Lewis Equipment Co., Bresler's 33 Flavors, Custom Woodwork & Design Inc., Proctor & Gardner Advertising Inc., Aloha Freightways Inc., Dura Metals Sauerman Bros. Inc., Sir Timothy Tobacco Shoppe, Type Tech Graphics Ltd., Western Auto Store, Disk-Tec Inc., Pete's Meat Market, Crossroad Ceramics, Bonnie's Hallmark Shop, National Sheet Metal, Gerhard Tool & Die Inc., Lox Stock & Bagel Restaurant, Triad Circuits Inc., Jandon Graphics.

These Illinois businesses have one thing in common: They all have benefited from a Small Business Administration (SBA) loan program. Some wouldn't exist without the SBA; others would not have been able to grow as quickly as they have. While it may be easy for some to say that government benefits may not have been justified, I would suggest that the small business owners and their employees would disagree.

The SBA, in existence since 1953, suffers from the lingering image of an agency that makes grants disguised as loans to small businesses. While the Reagan administration perpetuates this myth, the image is simply untrue.

The SBA plays a vital role in meeting the credit needs of the small business community. True, the SBA has its deficiencies. But the Reagan administration's plan to dismantle the agency must be defeated.

Let's examine the image and facts.

Misconception: Most loans are made to bars, restaurants and car dealers.

Fact: Of all SBA loans approved for Illinois firms in fiscal year 1983, only 9.8% were made to restaurants, liquor stores and/or bars, and less than 0.5% were made to auto dealerships. SBA loans cover a broad spectrum of companies generally corresponding to the mix of business in any community.

Misconception: The SBA displaces the role of private lenders and banks.

Fact: The SBA enhances the role of local banks.

With an SBA guarantee, banks can make loans with longer terms, lowering the borrower's debt service. A recent Government Accounting Office survey indicates that 30% to 40% of long-term bank loans carry an SBA guarantee. Market forces have made it extremely difficult for local banks to extend credit for longer than three to five years without some sort of guarantee.

With a guarantee, banks can permit lower down-payments when financing fixed assets. This enables the small business to preserve its cash in working capital instead of locking it up in building and equipment.

With a guarantee, a bank can extend fixed-rate loans, eliminating the risk of rapidly fluctuating interest rates for the borrower.

With a guarantee, a bank can assist with credit requests that exceed its lending limit, a problem in smaller communities. This is possible since only a bank's unguaranteed share is counted against its legal lending limit.

Taken together, these benefits provide small businesses with a lower, predictable debt service, healthier balance sheets and a more prudent use of precious working capital.

Misconception: More than 77% of SBA loans go to companies that currently have or previously received financial assistance from the SBA—the implication being that the SBA is throwing good money after bad.

Fact: In fiscal 1983, only 16% of SBA guarantees were made to current or prior recipients of SBA loan guarantees. Of those companies returning to the SBA, most tend to have new opportunities for expansion that require additional financing.

For example, Cynthia Strauss started her part-time zinc-plating business, called Chem-Plate, in Elk Grove Village in 1979 with two employees and an SBA-guaranteed loan. Her company was such a success that she now employs 40 persons, and recently went back to the SBA for a loan to help her expand into heat treating.

Misconception: Assistance programs offered by the state of Illinois wouldn't be affected by the elimination of the SBA.

Fact: Several of the more innovative programs sponsored by the Illinois Department of Commerce and Community Affairs make extensive use of SBA loan guarantees. For example, the Illinois Fixed-Rate Loan Fund is a pilot program sponsored jointly by the state and the SBA. The fund provides businesses with fixed-rate financing while creating new jobs for low- and moderate-income workers.

Misconception: All SBA programs have high default rates.

Fact: The SBA's 503 loans, a relatively new program, have a default rate of only 1%. This can be attributed to the stringent underwriting criteria developed by the SBA and the long-term commitment required of the participating banks.

SBA 7(a) guaranteed loans, the bank loans that make up the vast majority of SBA loans, have a default rate of about 10%. While this is too high, the statistic is somewhat misleading. Historically, more than 70% of delinquent 7(a) or 503 loans eventually return to current status.

Direct loans, historically a big problem, have a default rate of 34%. These loans account for only 6% of the SBA's total budget, yet command a disproportionately large share of the agency's resources. The SBA itself has often attempted to eliminate the program, but has been thwarted by congressional action. Congress has, in the past, seen this program as a popular and vital one in that it provided small business a "lender of last resort."

Misconception: The SBA has been ballooning in size.

Fact: The SBA voluntarily decreased its administrative size by 27% during Mr. Reagan's first term. In 1981, the president asked every agency except the Department of Defense to pare its request for funding by 25% in an effort to balance the budget. Only the SBA took that challenge seriously.

The truth is, the good the SBA does cycles through the entire economy via employers such as Chem-Plate, Federal Express, Proctor & Gardner Advertising and the thousands of other companies that have been helped by the SBA.

No one would argue that refinements shouldn't be made. The elimination of the direct-loan program would be welcomed, as would a further tightening of credit criteria. However, at the expense of a quick fix today, we may be sacrificing our economic vitality tomorrow. ■

Robert G. Heard is manager of Chicago Industrial Finance Corp. and a member of the Coalition of Small Business Advocates.

The CHAIRMAN. Thank you very much.

I will be getting to questions for all in a minute.

Mr. Green.

Mr. GREEN. I am Ed Green. I am the chief executive officer of Pandick Press. We recently went on the New York Stock Exchange. We are glad to have this opportunity to tell the committee and yourself our history with the SBIC.

We did not have a guaranteed loan from the SBA. We went into a risk situation where we could not raise the money. We had an opportunity with a death of a previous owner to purchase a small decadent printing company, and with this risk capital which originally was $400,000, and then we went back. It was in 1961 so we are old timers with the SBA.

In 1965 we had another opportunity and they came up, the same group of three SBIC's came up with a half a million dollars to enable us to move into the high tech area and computerize our operation and move from a company that was actually in bankruptcy when we took it over. It has a deficit of $2 million to our present net worth of about $41 million. The volume was roughly around $6 million in 1961. Last year we are happy to say it was $157 million.

I would like to put some facts on the table because I think this is important and was not discussed by Mr. Stockman and passed over, I thought, lightly, passing over the last of the 10 people you listed who have been successful. There are many, many more people, and I do not think you can pass over that that easily and that lightly the fact that the successes, oh, yes, there are going to be successes but you do not count them. You only count the losses.

Well, when you consider the growth of so many of the corporations that have started with help from the SBIC's and you take what they pay and look what we pay. We paid a total now of $37 million,in Federal taxes. We have paid $12 million in that period city and state taxes. We only made $49 million so it was 50-50. We paid our full share of the taxes.

Our payroll this last year was $63 million. We started out with 152 people. At the present time, we have over 1,500, all of whom are paying taxes, all high tech people, computer-oriented, computer trained. We took people who were linotype operators, converted them to computer operators, gave them a whole new technology and opened up a whole new field for our industry.

So I think you have to look at successful stories just as well and what they are contributing as well as the fact of the guaranteed loans and the defaults and everything else, because these are intangibles. They are very tough to put your hand on.

But I agree with you when you mentioned the fact. You just had ten of them. I can think of 100 or 200 that are making major contributions, providing jobs, and doing, I think, a great job in the high tech area.

Thank you.

The CHAIRMAN. Thank you, Mr. Green.

I want the essence of what is represented here to come across in the simplest of terms so that people will understand what we are dealing with. So, the questions will be similiar for all three of you.

First of all, let me start with Dr. Saigh. As I understand it, your first loan was a direct loan.

Dr. SAIGH. Right.

The CHAIRMAN. In the amount of $50,000.

Dr. SAIGH. $50,000.

The CHAIRMAN. $50,000. You obtained this after you were unable to get a loan through normal channels?

Dr. SAIGH. Right.

The CHAIRMAN. Did you get any subsequent financing from SBA?

Dr. SAIGH. Any what?

The CHAIRMAN. Any further financing or just that first loan?

Dr. SAIGH. No. We had the first loan, paid it off, and then we got a subsequent loan for expansion.

The CHAIRMAN. For expansion. Now, at the time of the first loan of $50,000, how many employees did you have?

Dr. SAIGH. Forty employees.

The CHAIRMAN. How many employees do you have today?

Dr. SAIGH. 325.

The CHAIRMAN. How much were you paying in taxes at the time of your first restaurant roughly? I am talking about the corporation.

Dr. SAIGH. I do not have that figure. I am sorry.

The CHAIRMAN. Can you rough out what is being paid now? Is that public information?

Dr. SAIGH. It is public information, but I do not have it.

The CHAIRMAN. In other words, it is a sizable tax bill that you pay?

Dr. SAIGH. Right.

The CHAIRMAN. That is, the corporation.

Dr. SAIGH. Right.

The CHAIRMAN. In addition to the taxes that are paid by the individuals that work for you?

Dr. SAIGH. Yes.

The CHAIRMAN. Certainly I would say at least 100 times or more from whatever the original loan was to your company.

Dr. SAIGH. Easily.

The CHAIRMAN. Ms. Straus, can you, again, handle these questions? Again, you had two loans?

Ms. STRAUS. Right.

The CHAIRMAN. One at your inception; one for your expansion.

Ms. STRAUS. Right. We received the 90-percent guaranteed loan after going to quite a few banks who refused to give us any money whatsoever, and finally a banker said if you can get the SBA to guarantee your loan, I will give you the money.

Now, he put together the package for us. He did most of the administrative work for it. So the SBA was really only involved as a committee to approve the package. They really did not have to do a great deal of administrative work at expense to the taxpayers to put it together.

The CHAIRMAN. If I can just stop you on that point because, again, we are dealing in perceptions.

Ms. STRAUS. Right.

The CHAIRMAN. I think everybody should understand the exact point that you have made which is that all of you had to go to your bank. Nobody went to the SBA and then the SBA ordered the bank what to do.

Ms. **Straus**. Right.

The **Chairman**. You had to pass the requirements of the bank first.

Ms. **Straus**. That is right, and I think another important point that needs to be made is that banks have lending limits. Mr. Stockman was saying that this money is just—that somebody else would have got our $60,000 if we did not get it, if the SBA was not there, and that is not really true because with the guarantee of the Government, they can lend an additional $60,000 because their lending limit does not include what is guaranteed.

So it does, indeed, create additional money for business. It is not trading dollars from one business to the other, and I did greatly object to that point that Stockman made.

The **Chairman**. If I can again just emphasize the point that you made.

Ms. **Straus**. OK.

The **Chairman**. In a letter to the committee from the Independent Bankers Association of America, Mr. Kenneth Gunther, director, states in paragraph 6. "According to the best information available, the SBA Loan Guarantee Program has no significant impact on the availability of credit to small businesses not using the program." So that confirms, in other words, what you are saying.

Ms. **Straus**. Right, because, for instance, this 503 Program that we got involved in for our heat-treating equipment, we are buying collateral. Now, most banks want collateral prior to the purchase of it. They do not want you to purchase something and use that for collateral, and that makes it very difficult for a business like ours to move into a major capital expansion.

The 503 Program, once again, all the papers, all the documents were put together by the development corporation and our bank which the SBA does not pay for, and all they had to do, they met for 20 minutes at a committee meeting to approve the loan. That was it.

And it allowed us to essentially triple our capital investment, and when you consider the ripple effect of these kind of investments, there is more than just our payroll taxes and our corporate income taxes at stake. There is actual equipment and purchases being made that affect the economy in ways that you cannot count, that you cannot add up in his statistics.

The small percentages of businesses that are helped by the SBA, I feel that that is an unfair statement on Mr. Stockman's part also because the SBA does not have unlimited funds to make loans.

So these numbers are percentages forced by the amount of money that is available for them to lend. So it makes the percentages very unfair when you look at the actual number of businesses helped.

The **Chairman**. Thank you very much.

Again, I know that you briefly alluded to it but I would ask you to repeat the experience, Mr. Green, of Pandick Press vis-a-vis its original loan, its original employment, its original tax bill, and roughly what the situation is today in these categories.

Mr. **Green**. I did not have time because I got back late yesterday afternoon to prepare testimony. I had forgotten a few things I would like to say, too, which I think are important. Your relationship within SBIC is their ongoing interest. Well, basically they put up $400,000 in a very risk situation where we could not raise the money through any other means. We were able to get some front money, but they had us take subordinated debt which it was paid off.

Then we went back again for another $475,000. In the meantime, these three gentlemen, one from Allied Capital which is here in Washington; Capital Southwest of Dallas and Virginia Capital of Richmond, VA, put up an additional $475,000 in 1965 and another $200,000 in 1966, all of which was repaid by 1970, 1971.

The point I wanted to make and I missed before is that in the SBIC Program these gentlemen served on our board. We were not experienced managers. We did not have the depth of management. They served on the board and were great devil's advocates. They were a great help in steering the business, watching the investment. We met every month, and they performed a tremendous function to our company in the growth and the decisions, directions, strategy, and the planning which SBIC's tend to do even though their money is paid back.

I think that is a big factor that nobody has mentioned. The SBA I think, too. I do not know how much they supervise the type of guaranteed loan, but I know they watch very carefully and help tremendously.

We publically said this in our annual meetings and to our stockholders, and again, as I said, we are very happy to be able to tell your committee who, as I know, has some tough decisions to make how we feel. We feel very strong in this program. We would not be where we are today. We would not be anywhere.

The CHAIRMAN. Thank you for coming by and saying so. I was surprised to hear the comments of another corporation earlier, Apple, which, again, I would suspect, and I do not know since they are not here to testify, but maybe their first contacts were also through an SBIC. Again, I have to repeat to everybody that the SBIC program is a part of the SBA, and the SBIC's are slated for extinction by the proposal of Mr. Stockman.

Mr. GREEN. I think it was very good that you brought that up because there was no mention of that that it was all guaranteed loans and the SBIC is a big part of it.

Ms. STRAUS. I also wanted to say, as far as Mr. Stockman's claim that you pay lower interest as the result of assistance with the SBA. That is absolutely false because we have never paid lower interest because of the help of the SBA.

Mr. GREEN. That is right.

Ms. STRAUS. And the second thing is that the longevity of the loans for us has not been as extensive as he talked about, and some of the other people that I have been involved with, that has not been true either.

Now, we started our business in 1979 when the economy was not in great shape to be starting a business, and the SBA has been the one source of funds that has always been there no matter what the state of the economy.

If there were no deficit, I will grant you it would probably be easier for businesses like mine to borrow money, but the fact of the matter is we have a major deficit. It is not going to go away tomorrow, and as long as it is there, we need this kind of help.

The CHAIRMAN. Thank you very much.

Dr. Saigh.

Dr. SAIGH. While I was preparing this statement, I wanted to recall from an article that was done by Charles Burnstein in the Nation's Restaurant News sometime ago. They had a statement in it from General Mills chairman or president. I cannot remember exactly. That is why I did not want to use it. I could not remember the date he made the statement.

But he was saying essentially that the company attempted in its restaurant divisions to innovate new concepts, and it cost them so much money that they gave up that idea entirely and began to actively acquire smaller companies who have already tested the concept and the new innovational ideas in the restaurant industry.

But anyway the National Restaurant Association under Ron Sarenson sent for this article or inquired of Charles Burnstein if he could recall that article. But he sent us another one that will not be due to be in print in the Nation's Restaurant News until March 4. He sent that by express, and I would like to enter that into the record because it is called "Little Guys Haven't a Hope Without the SBA."

The CHAIRMAN. Thank you very much, and it will be a part of the record.

[Material follows:]

EDITOR'S CORNER

'Little guys' haven't a hope without the SBA

By Charles Bernstein

Congress is considering an Administration budget plan that would eliminate the Small Business Administration completely. This plan—coming on the heels of a proposal to set ceilings for business meal tax deductions—is raising eyebrows in the food-service industry, which depends heavily on the S.B.A. for its entrepreneurial push.

In the battle against the deficit, elimination of the S.B.A. could save $1 billion or $2 billion after the 4,000 employees are dropped and the loan portfolio sold. Or if the S.B.A. is restructured, as some critics have demanded, perhaps $500 million would be saved through a less risky loan program that would cut down on defaults.

But the overwhelming fact is that in the long run, without an S.B.A. loan program on which to depend in a crisis, more potential jobs would be lost in restaurants than could ever be gained as small- and medium-sized restaurants would be deprived of opportunities to ever start their businesses.

More than economic losses to the work force and to consumers, there would be the potential loss of diversity and ideas fostered by independent restaurants. It is the "little guy"—whether a diner or a 30-seat fine-dining establishment—who is still the lifeblood of this industry. And it is the "little guy" would suffer the most from loss of the S.B.A.

Chains or conglomerates with large resources don't need the S.B.A. They can go to the bank for loans if they don't happen to have the cash.

But small independents who want to start restaurants or open additional ones can't necessarily obtain financing from banks at any sort of reasonable terms. They have to depend on the S.B.A.

Of course, many chains have started from tiny enterprises which couldn't have been born without S.B.A. help. Others might not have grown into forceful chains without S.B.A. help. One prime example is Chili's, where a Texas branch of the S.B.A. decided to take a chance and invest $100,000 in Chili's future five years ago. (That investment has been repaid many times over.)

Certainly President Reagan has a valid point in trying to get private enterprise rather than the Government to finance and build as much as possible. But in this particular case the S.B.A. is urgently needed for those who simply can't obtain the capital to get started.

Franchisees as well as independents have to be able to depend on the S.B.A. for help and expansion. Since the restaurant industry has far more smaller volume (under $500,000 annual volume) operators other than industries, this is the industry that would be impacted the worst.

One prominent industry source calls the plan to abolish the S.B.A. "an unmitigated disaster" if it happens.

Hopefully, enough small—and big—food-service companies and operators will make their views heard loudly on Capitol Hill on this issue that means so much to the future growth and diversity of the restaurant industry.

LETTERS

Remembering Bob Neville

Editor, *NRN*:

Your story on Bob Neville (*NRN*, Jan. 21) was warm, well written and moved me to tears. Bob was my coworker during my three years with the National Restaurant Association—your account of his strengths and abilities was exactly on target.

I'm so pleased you presented this final look at a man so many of us cared for. I'm sure he'd be thankful. Indeed, that too is the kind of man he was.

—Laura Phillips Bennett
president
Bitner & Bennett Public Relations
Miami, Fla.

• • •

Editor, *NRN*:

The late Bob Neville and I, among 305 others, graduated from Officers Candidate School in Quantico, Va., in January 1942, and subsequently, from the Reserve Officers Class which followed.

Bob and I served subsequently in the same battalion in the South Pacific, on the same Division staff in Korea, and on the same Corps Staff in Vietnam. We also served together on several bases in the U.S., including Headquarters, U.S.M.C.

I am currently involved in recreating an old graduation book (similar to a high-school or college annual) of our 1942 Reserve Officer Class from Quantico, Va.

As I trust you have gathered from the tenor of this letter, you are not the only admirer of Bob Neville. You simply got on the train a little later.

—Drew J. Barrett Jr.
Colonel U.S.M.C. Retired
Daphne, Ala.

• • •

Editor, *NRN*:

Your article on Bob Neville captures the essence of a man whose stature is not measured in inches of height but in the principles for which he stood.

Your account is an accurate reflection of my knowing Bob as a coworker, colleague, and true friend. I was privileged to have known him and he will be missed.

—Gary L. Hotchkin
director of operations
H[illegible] National Accounts Division
Hartford, Conn.

• • •

Editor, *NRN*:

Please allow me to compliment you and express my sincere thank you for the fine article devoted to Robert "Bob" Neville in your Jan. 21 issue.

His loss is certainly a significant one to our industry and will be felt for many years to come because of the excellent leadership and strong legislative efforts he contributed over so many years. His commitment and dedication to the NRA and to its entire membership will be deeply missed.

On a personal side, I was fortunate to be a co-staff member with Bob and certainly have had the highest regard for him as an individual. His warm, sincere caring manner, his soft-spoken tone and his genuine desire to have everyone around him look good are qualities much needed in any executive.

A side of Bob Neville rarely seen was his sense of humor, which was very evident in a soft sort of way. He was certainly an example for all.

I join with so many throughout our nation who were lucky enough to have contact with Bob Neville. The memories he has left with us will be cherished for years to come.

—Franklin D. Feiler
president
Feiler & Associates
Palm Beach Gardens, Fla.

• • •

Editor, *NRN*:

It was so good to read your eloquent article in *NRN*. I first met Bob when he joined the NRA staff in 1968 (I was director of education at that time), and my friendship with Annie and Bob has been a very warm one over all these years.

You certainly chose the correct adjectives to describe Bob; he deserved them all. And yet he had a great sense of humor too. The adjectives would certainly have amused him. We'll miss him very much.

—Chester G. Hall
director
Chicago Hospitality Institute
Chicago, Ill.

C-store threat

Editor, *NRN*:

Your recent editorial (*NRN*, Feb. 4) advising food-service operators not to ignore the "c-store threat" was right on the button. It's certainly a situation that operators must be wary of—and food-service manufacturers can take advantage of.

I've passed on copies of the story to our clients just in case they missed it.

—Laura Glaza
Campbell Mithun Advertising
Chicago, Ill.

Reacting to trends

Editor, *NRN*:

I thought about this reading your Jan. 21 story on the rebirth of home cooking and the piece on "gourmet" hamburgers.

As with all strong trends, there's always a reaction. The seafood and chicken movement has gone on so long and is so basic, however, that I don't think there's much danger any reaction will change what's happening to them or to red meat.

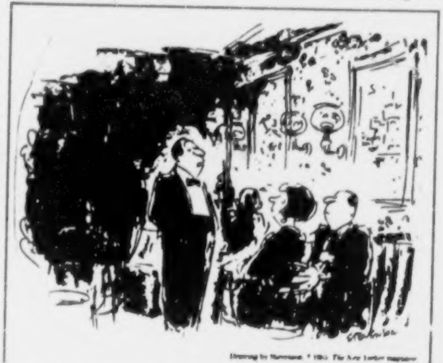
As with women's fashions, it will become increasingly O.K. to eat a great variety of foods. Thin and light are here to stay, but the great American consumer will not feel as constrained to avoid other (likeable) things. That's one of the reasons why deep frying is still so big, and will remain important. And the closet steak eaters will certainly be able to come out of the closet.

The concern with the "healthfulness" of what we eat will continue to grow. I've just had some fascinating conversations with college food-service directors. They are impressed with the increasing concern of their students with the values in the food they eat—although, again, not to the exclusion of other considerations.

One answer probably lies in the amount of protein that people eat. This relates to cost as well as "fill." I haven't seen any numbers, but I'd guess the number of 16-oz. steaks sold by the industry has dropped considerably. I think Red Lobster is on target with its "Seafood & Pasta" combinations—neatly solving the cost *and* the "too light" problems for those who want a bit more for a bit less.

Keep at it. *NRN* continues to focus on the issues.

—James S. Wattenmaker
president
Wattenmaker Advertising
Cleveland, Ohio



Drawing by [illegible] © [illegible] The New Yorker Magazine

"Tonight's specials are a kind of hamburger thing with a weird sauce, some sort of strange fish, a veal—I think it is—stuffed with God knows what, and"

The **Chairman**. Again, I want to thank all three of you. It was a great effort on your part to come down here and give this testimony. I hope that that aspect of whatever government does, really, if it is doing its job, comes down to people. We can have all these documents and figures in the world here. But what does it have to do with people?

The three stories that you have told, in addition to the ones that were told last week are a very good indication of the accomplishments of the SBA lending program. And this is testimony from those who are directly affected and not from banks, I might add, who, admittedly, might have an interest in this.

I think the Nation should know in terms of employment, that the Small Business Administration is where all the new employment is coming from. It is not coming from General Motors and it is not coming from Proctor & Gamble or any of the big corporations. It is coming from all of you, as represented by the various success of stories you have told.

Now, if this is going to be a nation of just big business, it is also going to be a pretty stagnant nation when it comes to employment. And regardless of the record employment figures that we have, we also have record unemployment, and this is the only way it is going to get solved.

So that is what is at stake here—not just a mess of figures. Thank you very much and we greatly appreciate your testimony.

Dr. **Saigh**. Thank you. It was very enlightening.

Ms. **Straus**. Thank you.

The **Chairman**. The next witness will be the Administrator of the Small Business Administration, James Sanders.

Jim, do you have an opening statement which you care to submit at this time for the record and synopsize or proceed in any way that you care to.

STATEMENT OF HON. JAMES C. SANDERS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Mr. **Sanders**. Thank you, Mr. Chairman. I do have an opening statement. I would like to synopsize it. I would like to thank you for the invitation to participate this morning in your legislative hearings on Senate bill 408, a bill to authorize SBA program funding for fiscal years 1986, 1987, and 1988.

With the help of the distinguished members of this committee, we have made some progress in redefining the proper role of the SBA. Today this agency is more responsive to the American small business community which has naturally become more supportive of many of our program activities.

However, as you are acutely aware, the deficit spending crisis has taken on overwhelming significance and forced a much more comprehensive review of budget priorities.

On many occasions I have taken note of the fact that the greatest contribution this administration has made to the Nation's small businessmen and women is the advancement of an economic policy which created a favorable business climate and brought unprecedented growth. We are on the verge of realizing a true opportunity society, one in which even the most traditionally disadvantaged individuals will have the freedom to participate in mainstream American business. Deficit spending is the one dark cloud which threatens to send us reeling back toward a no-growth economy.

Clearly then, the greatest service that the President can render to small business today is to bring the deficit under control by curtailing some of the services that Government now performs. We must engage in a reevaluation of our traditional role and establish priorities which distinguish between essential services and those which can be foregone.

Even with the support of the most well-intentioned government programs, no business, large or small, can flourish and grow in the absence of a strong, vibrant national economy. Today Federal spending so seriously imperils the continued economic health of this country that it must become our primary concern with respect to maintaining the long-term viability of small business. A capital-oriented small business cannot function when its source of capital is held hostage by a massive deficit caused by a government which spends too much.

This administration recognizes that small business, as the backbone of the American economy, must retain a prominent voice in the governmental affairs at the Federal level.

Mr. Chairman, the interests of small business will best be served by the adoption of the President's budget proposal, and I therefore must oppose Senate bill 408.

In conclusion, Mr. Chairman, I want to take this occasion to thank you for your leadership in demonstrating over the past 3 years the support of my management objectives to change the course of this agency. Your cooperation and understanding have contributed to the progress we have achieved.

Thank you.

[The prepared statement of Mr. Sanders follows:]

Mr. Chairman and Members of The Committee:

Thank you for the invitation to participate in your legislative hearings on S. 408, a bill to authorize SBA program funding for fiscal years 1986, 1987, and 1988. Before answering your questions regarding specific SBA programs, I would like to provide a brief overview of this Agency's position on funding authorization.

Since my confirmation in 1982, I have appeared before you each year to present the SBA's budget request. These hearings have focused on our attempts to bring about serious reforms in the relationship between the Federal Government and the Small Business Community. The philosophy of this Administration has been that, in promoting and assisting Small Business, our goal should not be to guarantee success, but rather to take appropriate steps to provide the opportunity for small businesses to compete freely in this nation's economic system.

With the help of the distinguished members of this committee, we have made some progress in redefining the proper role of the SBA. Today, this Agency is more responsive to the American Small Business Community, which has naturally become more supportive of many of our program activities.

However, as you are acutely aware, the deficit spending crisis has taken on an overwhelming significance and forced a much more comprehensive review of budget priorities.

On many occasions I have taken note of the fact that the greatest contribution this Administration has made to the nation's small business men and business women is the advancement of an economic policy which has created a favorable business climate and brought unprecedented economic growth. We are on the verge of realizing a true opportunity society -- one in which even the most traditionally disadvantaged individuals will have the freedom to participate in mainstream American business. Deficit spending is the one dark cloud which threatens to send us reeling back towards a no growth economy.

Clearly then, the greatest service that the President can render to small business today is to bring the deficit under control by curtailing some of the services that Government now performs. We must engage in a re-evaluation of our traditional role and establish priorities which distinguish between essential services and those which can be foregone.

Even with the support of the most well-intentioned of government programs, no business, large or small, can flourish and grow in the absence of a strong, vibrant national economy. Today, Federal spending so seriously imperils the continued economic health of this country that it must become our primary concern with respect to maintaining the long term viability of small business. A capital-oriented small business cannot function when its source of capital is held hostage by a massive deficit caused by a Government which spends too much.

This Administration recognizes that small business, as the backbone of the American economy, must retain a prominent voice in the governmental affairs at the Federal level.

Mr. Chairman, the interests of small business will best be served by the adoption of the President's budget proposal, and I therefore must oppose S.408.

In conclusion, Mr. Chairman, I want to take this occasion to thank you for the leadership you have demonstrated over the past three years in supporting my management objectives to change the course of this Agency. Your cooperation and understanding have contributed to the progress we have achieved.

The CHAIRMAN. Thank you very much. I would like to make it clear at the outset that your presence here is at my request, indeed it might even be said, my insistence. In response to my query and to the queries of the members of the staff, you have indicated support of the administration's decisions.

On the other hand, I think it also fair in terms of the debate on this matter that those charged with the responsibility of making decisions as to whether SBA ought to be eliminated, specifically the Members of Congress, should have the opportunity to ask you questions as to what programs are working and what are not working at the SBA.

I have no doubt as to the candor of your response. Whether we are on opposite sides of this issue, which we are, your candor is something that has been refreshing during the tenure of your office, and I know it will continue to be.

Congress has never targeted any specific industry for SBA loans. Do you think we should? And I ask that because today we heard criticism because SBA loans went to Main Street America, to bars, to restaurants, to liquor stores, auto dealers. Do you have any comments on the role SBA should play vis-a-vis serving Main Street America's small businesses?

Mr. SANDERS. That is correct, Mr. Chairman, we have never targeted any kind of industry or business in our lending or financial activities. As a matter of fact, we have rather avoided anything that might smack of national industrial policy.

The CHAIRMAN. That is what I could not understand. It seems to me in a philosophical sense that that is something the administration would not want to do—give direction to the economy. And it has been my impression certainly over the years that the criteria for assistance in whatever form has never been what business you are in. Obviously there are certain things that are over the line, but basically any type of business qualifies if it is a legitimate business.

Mr. SANDERS. It is marketplace driven, right.

The CHAIRMAN. We have heard a great deal about subsidized credit today at the Small Business Administration. What is the interest rate for SBA guaranteed loans?

Mr. SANDERS. Well, the guaranteed loans carry the prime rate plus 2¼ or 2¾ rate cap on them. That is the guaranteed rate in the certified lending program. I think you know also that we have innovated at what we call the preferred lending program in which we do not have a cap on the interest rate. We feel that we should let the market make its choice in that direction and that has been pretty successful. We are pleased with the results so far. I think it opens up more competition because the cap was kind of a target rather than a cap.

The CHAIRMAN. What we are talking about then is roughly somewhere in the area of 14 percent loans?

Mr. SANDERS. That is right. With the prime rate plus 2¾ you would be in the area of 14 percent.

The CHAIRMAN. What is the average term of the loan? GAO indicates that approximately 74 percent of SBA guaranteed loans are over 6 years.

Mr. SANDERS. Would you repeat that question? I am sorry.

The CHAIRMAN. I am asking what the average term of the loan is. The GAO report that we have indicates that approximately 74 percent of SBA guaranteed loans are over 6 years.

Mr. SANDERS. Most of our loans in the portfolio mature in 10 years. I think the average length of life of the loan is something like 7 to 8 years, yes.

The CHAIRMAN. In short, the Guaranteed Loan Program, then, is giving small firms a break on term but not on rates, is that a fair summary?

Mr. SANDERS. That is correct. As a matter of fact, that is the only way that we have continued to push this program of guaranteed lending. As you know, we have been on record for getting out of the direct lending and other activities such as disaster lending, but we have felt that the banks have continued to use the guaranteed lending as an extra arrow in their quiver, if you will, to provide term lending to small businesses that are good small businesses, not anyone that is going to fail. We put out the word that we are in the quality lending business, not trying to finance people who do not belong in business.

The CHAIRMAN. Would a good example of the importance of term to small businesses be the recent recession when, I might add, the figures are just enormous as to the failure of small business—would that be a fair example to use insofar as the importance of the need for longer term financing for small businesses with no large cash reserves? Many businesses could survive if they had that longer term. Was that a time in particular when the longer term small business loan was used most effectively?

Mr. SANDERS. Well, I think that is true. As I travel around the country, I talk to bankers and I said that the only program that we were trying to make some advance in was in the financial lending area which was the Guaranteed Lending Program, and if they did not have use for it, we would close it up right away, and overwhelmingly their testimony is, yes, this is an important tool to provide that extra term for successful or growing small business that we otherwise would not be able to bridge and make it a success.

So it definitely has contributed as a tool for them.

The CHAIRMAN. Is it not so, Mr. Sanders, that this committee and the U.S. Senate has cooperated with you in trying to eliminate the Direct Loan Program?

Mr. **Sanders**. Yes, sir, and I wish that the other side of the Congress would have been as cooperative. We could have probably been over this bridge by now in getting rid of both direct loans and hopefully the disaster loans.

The **Chairman**. Is it not also true that this chairman and this committee has cooperated with you in the sense of trying to eliminate the nonphysical disaster loan program and seeing to it the farmers' disaster loans should to be under the Farmers Home rather than the Small Business Administration?

Mr. **Sanders**. Mr. Chairman, you have been totally supportive of my efforts in that direction.

The **Chairman**. So this is not a new position insofar as this committee is concerned, but, to the contrary we have consistently worked with you on all those counts?

Mr. **Sanders**. That is correct.

The **Chairman**. What are the collateral requirements on SBA loans?

Mr. **Sanders**. Well, there are collateral requirements on loans. We do not put out a rigid formula but we require, first of all, the evidence of good business judgment. There must be reasonable evidence of repayability in the earnings plus taking collateral that is enough to ensure the taxpayers' investment in that loan.

The **Chairman**. Does that sometimes involve the individual putting up their home?

Mr. **Sanders**. Absolutely.

The **Chairman**. Mr. Administrator, consistent with this committee's position, you have placed a greater responsibility on the banks, the private sector, to make credit decisions involving the SBA Guaranteed Loan Program.

How effective has the certified lender program been? Has it improved loan quality?

Mr. **Sanders**. We believe it has, Mr. Chairman, and we believe, of course, that the move toward the 75 percent guarantees that we made in the Preferred Lending Program will improve it even more.

The loan portfolio, since we have made those changes, is a little premature to make a final determination, but the early indications are that, indeed, the quality lending standards in the certified lending and preferred lending program are improving the portfolio.

The **Chairman**. Mr. Administrator, what is the actual loss rate of the SBA's Direct Loan Program and what is the actual loss rate of the SBA's Bank Guaranteed Loan Program?

Mr. **Sanders**. Well, our current figures on the actual loss as that is computed, Mr. Chairman, on the guarantee portfolio, is 5.72 percent, and the direct loan portfolio is 14.88 percent.

The **Chairman**. Well, I want to reemphasize the point that was made since I think statistics are so important in attaching credibility to the various arguments being presented to the American people: the actual loss of the SBA Guaranteed Loan Program which is the only program I might add in the authorization bill before us—we will again this year seek to eliminate the Direct Loan Program—is 5.7 percent.

Last week a panel of bankers testified that the 7(a) loan program allows banks to provide small businesses with long-term capital not otherwise available. Is that your view?

Mr. **Sanders.** That is correct.

The **Chairman.** Last year Congress passed and the President signed a bill, Public Law 98-352, to improve SBA's secondary market program which for the first time permits pooling of the guaranteed portion of the guaranteed loans for sale in larger lots to investors.

What has been Wall Street's response to the new law and will it open new capital pools?

Mr. **Sanders.** Well, of course, there has been some real interest in Wall Street, because there will be some new investment firms in the market who sell to pension funds in large pools.

We feel that in the long run this will clean up the quality of the SBA guarantee. We also feel that we are going to see a better demand for the SBA guarantees in the pools and thereby probably lower the interest rate. Hopefully some of that interest rate reduction can be passed back to the consumer.

The **Chairman.** Under your leadership, the agency has stressed programs that leverage the private sector resources. I want you to describe the private sector delivery system that SBA uses to provide management assistance and financial help to small firms.

Now, let me just explain this map behind me here. This map depicts SBA's partnership with the private sector to deliver financial assistance and management assistance to small businesses. The black dots identify the cities where over 1,500 banks have 10 or more SBA guaranteed loans outstanding. The orange dots identify the locations of SBA 503 certified development companies. The red dots identify the locations of Small Business Investment Companies. [SBIC's], and Minority Enterprise Small Business Investment Companies. [MESBIC's]. The blue dots are the locations of small business development centers, and finally the green dots are the locations of small business institute centers.

Now, I think that illustrates the private sector delivery system. Could you describe this system which SBA uses to provide management assistance and financial help to small firms?

Mr. **Sanders.** Well, that has been probably the backbone of our management approach to the SBA, Mr. Chairman. The two parts of it are decentralization to our districts where the product and the service is delivered, and the other is reaching out and leveraging with the private sector in every activity the SBA is involved with.

I think you know this administration believes the private sector does it best, and we want to simply get in behind them and support them in their effort. In the management assistance area, of course, we have changed the average management assistance officer in the district office from a hands-on consultant to a manager of resources in which he may be dealing with a small business development center, managing the contract in which the small business development center itself deals with training and counseling and reaching out in that state to deliver management services.

The same thing applies to Small Business Institutes, to their relationship to the SCORE and ACE chapters of retired executives, to the chambers of commerce, and now that we have the enabling legislation to cosponsor with for-profit corporations, I see a whole new vista opening up in which we may truly have all of the financial burden transferred to the private sector with probably the best expertise available in the country at work for small business.

The CHAIRMAN. Now, the point that I want to make and that you have made in the course of your response—and is made up here in this map is that the local entities, the banks, the MESBIC's, the SBIC's, the development companies, make the first determination whether a firm is credit worthy, a good risk and has the ability to repay the loan, is that right?

Mr. SANDERS. That is correct.

The CHAIRMAN. That determination is not made in your office here in Washington, DC?

Mr. SANDERS. That is correct, particularly not in Washington, DC.

The CHAIRMAN. I noticed when we had Cray Research before us last week the vice president and chief financial officer said that when it came to their critical need for financing, they got it from a local SBIC, and he stressed local. He said nobody else knew us, and it was somebody that knew Seymour Cray, who had faith in him and who decided to make the loan. That was part of the criteria.

Mr. SANDERS. Absolutely.

The CHAIRMAN. And I think that reaffirms what it is you are trying to do—it is that local knowledge which governs and you are not just doling out dollars from Washington, DC.

Mr. SANDERS. And that has been the effort, Mr. Chairman, as you well know to try and remove from Washington, DC, that long loop of decisionmaking that puts so much delay in the process, make it at the local level, and of course, it has been this President's philosophy to get in behind the local community and help them when they determine where the assistance should go. That, of course, is the idea behind the 503 program.

The CHAIRMAN. Mr. Administrator, I am asked to make a decision. I am not saying I do not show my prejudice, but quite frankly, it is a prejudice borne of knowledge accumulated over the years.

For some of my other colleagues in the Senate, they do not sit on this committee. They have not had the day-to-day interaction that I have enjoyed. But all of us are going to have to go ahead and review the facts as presented by virtue of these hearings and make a decision.

Now, the Office of Management and Budget made a decision which was presented to the President. My question is: Did you have input into the decision of the Office of Management and Budget? Not the appeal, not the appeal. But at the time the Office of Management and Budget made its recommendation to the President, did you have input into that decision?

Mr. SANDERS. I think I can explain that a little better than in one word if I can give you a little background. Last month one of the leaders of the Office of Management and Budget was explaining to various other presidential appointees how they came to the decisions in the budget and he pointed out that they thought that there was a great peril in going out and seeking the input from the various agencies before they made the decision on the drastic challenge that they were facing in this overwhelming deficit problem.

Of course, I have said it over and over again. I think the great peril we have bar none to our future security is this deficit. It is going to eat us alive. These people at OMB said that they could not risk the secrecy element by inviting input at the time they were making these deliberations.

So that is why it was really a well-kept secret until it was announced at the cabinet meeting that all these cuts were being proposed by OMB. So that was their justification, and if I were in their position, maybe I would make the same determination. I do not know. But that was the reason that they did that, and I certainly have to share the concern about the overwhelming threat of the deficit. It has risen from 7 percent of our budget to 14 percent. It is well on its way to 20 if we do not do it. Pretty soon there will be no flexibility for us to govern in this country.

But nonetheless, that is how they determined that, and that is why they did not seek the input of certainly this agency, and I think that is true of most of the others.

The CHAIRMAN. Had you been asked, and I do not want to lead you, but I do not know how else to phrase this. Would it be safe to assume that you would have made recommendations of program elimination such as direct loans, such as farmer disaster assistance——

Mr. SANDERS. Yes.

The CHAIRMAN [continuing]. Such as nonphysical disaster loans and, indeed, maybe others that I do not know about, that you would have recommended severe cutbacks or eliminations on an individual program within SBA rather than the elimination of the agency?

Mr. SANDERS. Well, we have consistently made those recommendations as you know, Mr. Chairman, and in the budget bill last year made recommendations. We would like to see the elimination of these programs that we consider quite wasteful, those that have obvious subsidized interest rates involved in them. We certainly think those are not a service to the small business community and would have proposed the elimination of those and the improvement and the more efficient use of the private sector in our other programs. We would have been consistent in that direction.

I think we would have continued in that direction, made those recommendations. That is true.

The CHAIRMAN. Therefore, is it a correct statement that your support of the President's recommendation—and your support has been clearcut as I have indicated—is driven by the fiscal crisis rather than by the quality and benefit of the programs that you would not have eliminated?

Mr. SANDERS. That is correct. I believe some of these programs have a great deal of quality. We have heard eloquent testimony of the SBIC programs. I have known of that program, one of the few I knew about before I came from the private sector where I spent most of my life before coming to this job. Yes; I think we are now driven by an entirely different set of facts, that the deficit is certainly what drives my support in this area.

The CHAIRMAN. I have further questions for response to the record. Again, I want to thank you for your candor not just at this hearing but consistently. Again, I want to make the point through you that if I were a betting man it is that there is going to be a

Small Business Administration, and I would not suggest that all those under your direction start looking for other jobs.

I am very worried about that. If I can, just in passing, let me ask if there has been any demonstrable effect of the initial pronoucements on this matter vis-a-vis SBA personnel?

Mr. SANDERS. Yes; it is a very obvious result. You cannot have an announcement like this without it being of real damage to morale in the agency, and I have been on the phone to many of our district directors to see how things are going in their areas. I am pleased to say that I think the initial shock has warn off, that they are back at the desk doing the work and out in the field. They recognize we have a fully funded 1985 to deal with, and I think they have picked up.

We have lost some people. That is bound to happen, and sometimes you do not lose the right people. [Laughter.] I think things have begun to turn around. But it is a tough job.

The CHAIRMAN. That is what the President said when I was reelected in 1982. [Laughter.]

Thank you very much, and the committee will stand in recess.

[Whereupon, at 1:05 p.m., the committee recessed, to reconvene at the call of the Chair.]

[Additional material follows:]

LOWELL WEICKER, JR., CONN., CHAIRMAN
BOB PACKWOOD, OREG.
ORRIN G. HATCH, UTAH
RUDY BOSCHWITZ, MINN.
SLADE GORTON, WASH.
DON NICKLES, OKLA.
WARREN RUDMAN, N.H.
ALFONSE M. D'AMATO, N.Y.
BOB KASTEN, WIS.
LARRY PRESSLER, S. DAK.
SAM NUNN, GA.
WALTER D. HUDDLESTON, KY.
DALE BUMPERS, ARK.
JAMES R. SASSER, TENN.
MAX BAUCUS, MONT.
CARL LEVIN, MICH.
PAUL E. TSONGAS, MASS.
ALAN J. DIXON, ILL.
DAVID L. BOREN, OKLA.
ROBERT J. DOTCHIN, STAFF DIRECTOR
R. MICHAEL HAYNES, CHIEF COUNSEL
ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 5, 1985

Honorable James C. Sanders
Administrator
Small Business Administration
1441 L Street, N.W.
Washington, D.C. 20416

Dear Mr. Administrator:

Attached are additional questions that the Committee would like you to respond to for the record.

Please have your responses to the Committee by March 15, 1985. Your prompt attention to this matter would be most appreciated.

Sincerely,

LOWELL WEICKER, Jr.
Chairman

Enclosure (Omitted.)

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

March 20, 1985

Mr. Bob Dotchin
Staff Director
Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Bob:

Enclosed are the responses to the questions Senator Weicker asked in his March 5th letter following the hearing on the Small Business Administration's authorization bill, S. 408.

If I may be of further assistance please be in touch.

Sincerely,

Janine

Janine Perrignon
Assistant Administrator for
Congressional and Legislative Affairs

1. Mr. Administrator, what do you perceive the mission of SBA to be? Are the lending and management assistance programs designed to serve all businesses?

Answer #1 (a):

The broadly defined mission of the SBA is to promote and assist the welfare and development of the nation's small businesses. The SBA promotes small business by ensuring that, at all levels and in all departments of government, small business concerns are taken into account when public policy is established. A primary means of assistance provided by this agency is through our administration of programs which allow small enterprises the fair opportunity to compete for sales and purchases in the federal marketplace. Our role is not to guarantee the success of small businesses, but to pursue the maintenance of an economic climate which is conducive to individual opportunity and initiative.

Answer #1 (b):

ANSWER Since the Agency's founding in 1954, the target population for SBA-assisted lending has been those small businesses that are unable to obtain credit from lending institutions. In addition, however, 7(a) loans must be "of such sound value or so secured as reasonably to assure repayment."[1] In other words, a 7(a) loan is for a business strong enough to repay the loan but not strong enough to qualify for credit from a bank.

In its 1983 report the GAO found that SBA is fulfilling the intent of the law:

> "About 82 percent of lenders said that the small businesses to which they made loans would not have been financed without the SBA guarantee or would have had different financing terms and conditions. Although it is difficult to project what would have happened without the SBA Loan Guarantee Program, banks are often reluctant to make unguaranteed loans to small businesses under terms or conditions suited to their needs. Entrepreneurs contemplating the start of new businesses often find that financing is difficult to obtain. Many commercial lending institutions consider new business ventures usually are supported by weak collateral and lack an established track record.
>
> The objective of promoting full and free competition is specifically cited in section 2(a) of the Small Business Act (15 U.S.C. 631 (a)). In line with this objective, SBA's mission is to accept riskier loans and guarantee financing to firms that could not get credit on reasonable terms in the open market. SBA's 7(a) program is designed to meet this need."[2]

In defining the target population for SBA guaranteed lending, it is important to recognize a second characteristic: the target group consists primarily of firms that seek access to long-term financing. This subject was also discussed in the GAO report:

---

[1] Small Business Act, § 7(a)(6).

[2] GAO, SBA's 7(a) Loan Guarantee Program: An Assessment of Its Role in the Financial Market, April 25, 1983.

> Small businesses require long-term debt financing for a variety of reasons including plant expansion and acquisition and equipment purchases. However, they have had problems obtaining such financing as far back as 50 years ago and the problems that small businesses faced then are the same today.[3]

The GAO report describes studies and hearings published between 1935 and 1982 by the U.S. Department of Commerce, the Federal Reserve Board, the Senate Banking Committee, the Committee for Economic Development, and the Federal Interagency Task Force on Small Business Finance, each of which came to the same conclusion: that a serious credit gap exists in which many small businesses are unable to meet their needs for long-term credit.

It is the existence of SBA loan programs that has made possible what long term financing does exist for small businesses. In the early 1960's the SBA direct loan program provided a model. Now this has been superseded by the 7(a) guaranteed loan program. The GAO estimates that "approximately 30 to 40 percent of the dollar amount of banks' long-term financing (6 or more years) to small businesses may carry an SBA guarantee."[4]

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[3] Ibid, p. 14.
[4] Ibid, p. 31.

Answer #1 (b):

Clearly, an agency the size of the SBA cannot provide management assistance to all businesses, nor do all small businesses require outside counseling and training in order to operate profitably. The SBA management assistance programs, therefore, do not attempt to serve the entire small business community. The SBA does, however, undertake to assure that management assistance resources will be available to the maximum practicable number of businesses who are in need of such service. This effort is accomplished largely through the use of SCORE and ACE chapters in local communities which enlist private sector expertise from throughout the country. Further, a range of services, from on site management counseling for small firms to assistance requiring highly specialized technical expertise, is made available on a widespread basis through our SBI and SBDC programs which combine the resources of universities, the private sector, and F,S, & L gov'ts.

QUESTION 2 Mr. Stockman has presented an economic thesis that SBA loans discriminate against credit worthy borrowers. In short, these SBA loan recipients "crowd out" other small businesses seeking credit. What is your opinion?

Have you seen evidence of "crowding out"?

ANSWER The best evidence to date on this question is provided by the GAO, which surveyed a scientifically selected stratified random sample of banks that make SBA loans. GAO found that "lenders do not perceive the program as causing increased interest rates or excluding other small business borrowers from their local credit market."

I personally have not seen any evidence of crowding out of small business borrowers as a result of SBA loan guaranties. Indeed, as a result of the SBA Secondary Market, many lenders sell their SBA guarantied portions to investors and use the proceeds to make additional loans to small businesses.

QUESTION 3 What do bankers to whom you speak say about this "crowding out" theory?

ANSWER: Bankers with whom I have discussed this issue have views consistent with bankers' replies to the GAO: that in their own operations they do not see evidence of crowding out of small business borrowers as a result of SBA lending.

Question #4: What is the percent of repeat borrowers in the SBA lending programs in each of the last five years? Please advise the Committee why there was such a large discrepancy between SBA and OMB on this matter?

Answer:

	% Lending to Repeat Borrowers			
	Business		Disaster	
Fiscal Year	#	$	#	$
1980	17.5%	20.4%	5.1%	15.9%
1981	14.9	16.8	12.0	23.1
1982	14.4	15.0	2.1	8.3
1983	16.4	18.0	.5	1.6
1984	13.0	14.4	.0	.1

The Office of Management and Budget obtained this data outside of normal channels. In doing so, they by-passed the internal clearance process that would have recognized that the data was incorrect.

Question #5: Assuming a $12.0 billion portfolio, how much revenue would SBA take in, if the agency is permitted to service these loans? How much time would it take to service and collect this portfolio? What are the administrative costs involved in servicing this portfolio?

Please provide a detailed breakdown of the SBA loan portfolio, by program.

Answer: Assuming a $12.0 billion portfolio would infer that the FFB portfolio was converted to on-budget, and that there was no more new credit after FY 1985. Given those assumptions, it is anticipated that $9.6 billion would be collected. The average life of the portfolio is 9 years, however, it would take at least 15 years to totally amortize the portfolio. Based on today's servicing costs, the total administrative cost to service the portfolio for 1986-2000 would be approximately $612 million.

Question #5 (Continued)

An analysis of the $12.0 billion portfolio is as follows: ($ in millions)

	Average Maturity Years	Amount Outstanding 9/30/85
Direct Loans		
Business	6	$ 650
EOL	5	90
HAL	9	100
MESBIC	6	375
Disaster	7	3,775
DCL	10	260
Subtotal		$5,250
FFB Loans		
SBIC	6	720
503	16	1,160
Subtotal		$1,880
Repurchases		
Business	6	225
EOL	4	5
Guaranteed Loans	6	750
Future Purchases	6	1,500
Other	N/A	25
Subtotal		$2,505
Other SBA Loan Assets		
Delinquent Loans	N/A	730
Loans in Liquidation	N/A	1,689
Subtotal		$2,419
Total		$12,054

Question 6. The Reconciliation Act of 1981 got SBA out of farm disaster lending and required farmers to go to FmHA for disaster assistance. How effectively did that system work?

Answer: P.L. 96-302, approved July 2, 1980, required most farmers to go to FmHA for disaster assistance for disasters which commenced after July 2, 1980. Because of the relatively long lead times for agricultural disasters, the dramatic affect of this legislation did not become obvious until FY 1982, as show by this table.

FY	#	$ (Millions)
1981	15,234	886.6
1982	368	83.2
1983	3	.7

Question 7. As you know, P.L. 98-270 placed for the first time a statutory cap of $500 million on SBA's physical disaster program. With farmers now eligible, do you believe this cap will be reached in FY 1985 or FY 1986?

Answer: Because of the unpredictable nature of the number and severity of physical disasters which are part of the same $500 million cap, it is impossible to forecast physical disaster lending demand for FY 1985 or 1986. However, because of the relatively long lead time for agricultural disasters, we estimate that sharpest growth will be in FY 1985 and 1986. We estimate that farm loan demand in FY 1986 will be between $150-250 million.

Question 8. Is SBA equipped to handle this increased demand on the program?

Answer: Although we believe farmers should rely primarily on the Department of Agriculture for their financial assistance, we are prepared to handle the demand within our available resources, assuming that the level of disaster activity in the past 3 years remains fairly constant.

Question 9. S. 408 recommends the elimination of SBA's non-physical disaster program. Do you think this program should be eliminated?

Answer: Yes. In 1981 the Administration asked for the elimination of all nonphysical disaster loan programs. With one exception, Congress did eliminate these programs and the one exception was not funded. Funding and additional nonphysical programs were added by P.L. 98-270. We still recommend elimination of all nonphysical disaster loan programs.

Question 10. What was SBA's experience administering the PIK and Peso programs?

Answer: The final regulations were published December 24, 1984, effective January 7, 1985. Designations of economic injury areas started January 10, 1985. 295 counties in 22 states were eligible for PIK designations. At the request of the Governors, 285 in 18 states were designated. For peso, 36 counties in 4 states were eligible. At the request of the Governors, 30 counties in 4 states were designated. Also under §7(b)(3), one county was designated as the result of an Avian Flu quarantine.

As of March 8, 1985, program statistics were as follows:

Applications given out: Approximately 4,400.

Applications filed: 676 (551 PIK, 125 Peso, 1 Avian Flu).

Requested loans in applications filed: Approximately $100,000,000.

Applications processed: 249 (203 PIK, 46 Peso).

Applications approved: 96 (82 PIK, 14 Peso).

Applications declined/withdrawn: 153 (121 PIK, 32 Peso).

Approved loan amount: $14,904,000 (14,039,600 PIK, 864,000 Peso)

11. In 1958, Congress created Small Business Investment Companies (SBICs) to "stimulate and supplement the flow of private equity capital and long-term funds which small business concerns need for sound financing of their business operations and for their growth and expansion."

    a. How much equity capital has been directed to small firms since 1958?

       Answer:

       It is necessary first to define equity capital as financing that is provided to small concerns by the purchase by SBICs of debt securities and equity interests. Debt securities are included because they are a form of equity capital and in most cases those securities are subordinated, have lower current yields, little or no amortization, and include equity features such as being convertible to the common stock of small concerns.

       Using the definition as set forth above, SBICs have provided $3,090,438,000 of equity capital to small concerns, and Section 301(d) SBICs have provided $148,599,000 to disadvantaged small concerns. The SBIC amount covers the period from 1958 to the present time, the Section 301(d) amount covers the period from 1974 to present.

    b. Of that amount, how much was private paid-in capital?

       Answer:

       There is no way to directly identify the source of funds used for any specific type of SBIC or Section 301(d) SBIC financing because the total capital of these firms comes from various sources and the funds are comingled and fungible.

       However, we can make an estimate by computing the proportion of an SBIC's total capitalization, and thus total funds that are available for investment, that comes from private capital.

       For SBICs, weighted over the entire life of the program to date, private capital has been 53% of total capital. Therefore, we can estimate that of the $3,090,438,000 of equity capital provided to small concerns, $1,637,932,140 or 53% came from private capital sources.

       Section 301(d) SBICs' private capital has been 39% of total capital and thus of their $148,599,000 of equity capital provided to disadvantaged small concerns, $57,953,610 or 39% came from private capital sources.

c. How many businesses have received financing?

Answer:

We have actual data on the count of small concerns that goes back only to 1973. However, the statistical relationship between the number of financings and the number of businesses financed is strong enough to estimate the count for the period 1958 through 1972.

Combining the estimate for the early period (1958 through 1972) and the actual data from 1973 to date, we can estimate that 52,118 firms have been assisted in the life of the SBIC and Section 301(d) programs.

d. How many new jobs have been created?

Answer:

The number of new jobs created can only be estimated from samples we have taken showing the before-and-after job status of firms financed. These samples only relate to activity after 1973.

From the results of the sample, and relating job changes to dollars of SBIC disbursements (after converting to constant dollars), we have estimated that 250,599 jobs have been created from and including 1974 through 1984. This estimate is net of the effects of jobs lost as the result of normal business failures.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

March 20, 1985

Robert Dotchin
Staff Director
Committee on Small Business
United States Senate
Washington, D. C. 20510

Dear Bob:

Enclosed is the response to #12 which is the last of the responses requested from Senator Weicker in his March 5th letter. As you know, these were questions sent to Administrator Sanders following the hearing on the Small Business Administration's authorization bill, S. 408.

Sincerely,

Eleanore E. Cline
Acting for
Janine Perrignon
Assistant Administrator for
Congressional and Legislative Affairs

Enclosure

12. a. What percentage of the SBIC industry's investments are in "hi-tech" firms (e.g. semi-conducter, computer firms, and the like)?

The Small Business Investment Act of 1958, as amended, (Act) does not mandate the SBIC program to supply long-term loans and equity capital to high-technology small business concerns. It contemplates that the program provide long-term loans, and equity capital to all small business concerns in need of such financing. In addition, on an optional basis the Act contemplates that the SBIC program provide venture capital to small business concerns.

The Act contemplates that such long-term loans and equity financing be provided to small concerns for their growth, modernization, and expansion. Because of the intent to promote growth, and the fact that growth and high-technology usually occur in the same firms, the SBIC program has been identified as one that would assist firms in the high-technology industries.

Therefore, although the Act and SBA regulations define equity capital and venture capital, they do not define high-technology. For the same reasons, SBA does not track high-technology although we are aware of its significance.

Any definition to be ideal must clearly and unequivocally describe the attributes common to a set of objects that are to be included in the definition. It is clear that there is not any universally accepted set of attributes which might define high-technology and therefore any attempt at such a definition remains subjective and intuitive. Further, high-technology is a relative concept and is dynamic in that it is continually changing with accelerating frequency. Basically, high-technology is in the eyes of the beholder at a point in time.

The Federal Government's Standard Industrial Classifications although administratively convenient are not sufficient to classify firms on a current basis. The most recent version of those classifications is dated 1972, with the most recent supplement dated 1977. Clearly, there have been significant changes in technology in the thirteen years since the last version of those classifications have been published. Therefore, any analysis based on those classifications suffers from a lack of current relevance. The Federal Government through the Technical Committee on Industrial Classification was supposed to review the Manual in 1982 however no definitive changes have come forth from that review.

Annually SBA has made available the aggregate financings of SBICs subdivided into the 2-digit SIC codes. These data have been routinely made available to the public and the Congress in the interests of disclosing program activities.

Certain of these broad classifications are those in which are found most of the high-technology activity. The attached table covers the four-year period from 1981 thru 1984 and identifies seven major 2-digit SIC industries in which high-technology is most frequently found. This table shows that as of calendar 1984, 52.2% of SBIC financing disbursements were going to those industries.

Attempts have been made to analyze these data at a greater level of detail such as at the 4-digit level. However, this is subjective and inexact because of the lack of a clear definition as discussed above. Assuming there was a universally accepted definition of high-technology, within any so-called high-technology industry there still might be firms that were mundane. On the other hand, within an industry that might not be considered high-technology there might be firms that themselves would be high-technology. For example, one conservative study of high-technology did not include the SIC 8071 which is Medical Laboratories, however, in inspecting the firms classified in that industry a firm financed by SBICs was identified that "develops, manufactures, and sells high-speed, automated, nonisotopic immunoassay analysers... and sells to university research labs, and clinical reference labs." It would appear on the surface at least that this firm is into high-technology.

The ultimate or extreme level of detail and thus the only exact way to determine what percentage of SBIC financing is going into high-technology firms would be to first set forth a clear, exact, and universally accepted definition (or set of criteria) for determining high-technology firms, and then to measure each and every firm financed by SBICs against those criteria. This, of course, is not feasible given present time and resource contraints.

Taking into consideration the qualifications discussed above, it is estimated that the high-technology financings of SBICs were up to 52.2% of the total SBIC financings for calendar year 1984 depending upon the level of SIC detail used. For example, using Bureau of Labor Statistics Group 1 High-Technology definitions, the percentage is estimated at 48.3%. Attached are the following:

1. Table covering 1981 through 1984 showing SBIC financing in major 2-digit industries in which high-technology is most frequently found.

2. Tables showing 2-digit concentrations for calendar years 1979, 1981, 1982, 1983, and 1984.

3. Four-digit SIC total for year 1983. The same data for 1984 having previously been supplied. (Data for 1981 and 1982 are not available).

Industry Distribution
SBIC Disbursements

Industry Description	1981 ($/mill.)	%	1982 ($/mill.)	%	1983 ($/mill.)	%	1984 ($/mill.)	%
Electrical& Electronic Mach.	$35.5	10.7%	$33.8	10.5%	$50.7	12.3%	$52.6	12.4%
Machinery(Includes Computers)	$32.3	9.7%	$37.8	11.7%	$63.3	15.3%	$52.8	12.4%
Business Services	$20.3	6.1%	$16.6	5.1%	$28.1	6.8%	$38.2	9.0%
Communications	$20.2	6.1%	$25.4	7.9%	$26.6	6.4%	$35.0	8.2%
Instruments & Related Products	$14.9	4.5%	$14.8	4.6%	$12.6	3.1%	$20.7	4.9%
Health Services	$7.7	2.3%	$6.7	2.1%	$13.4	3.2%	$15.7	3.7%
Chemicals & Allied Prod.	$0.0	0.0%	$6.5	2.0%	$10.5	2.5%	$7.3	1.7%
Subtot. Major High-Tech	$130.9	39.3%	$141.6	43.9%	$205.2	49.7%	$222.3	52.2%
Food Stores	$13.4	4.0%	$10.9	3.4%	$14.1	3.4%	$14.3	3.4%
Restaurants	$11.1	3.3%	$9.0	2.8%	$15.1	3.7%	$11.5	2.7%
Food Manufacturing	$7.5	2.3%	$4.1	1.3%	$7.8	1.9%	$5.0	1.2%
Textile Mill Prod.	$0.0	0.0%	$0.0	0.0%	$8.4	2.0%	$1.0	0.2%
Misc. Retail	$0.0	0.0%	$5.9	1.8%	$7.9	1.9%	$7.4	1.7%
Oil & Gas Extraction	$30.3	9.1%	$25.2	7.8%	$17.3	4.2%	$10.9	2.6%
Building Construction	$20.2	6.1%	$15.6	4.8%	$11.1	2.7%	$11.2	2.6%
Real Estate	$11.0	3.3%	$7.0	2.2%	$6.1	1.5%	$3.9	0.9%
Fabricated Metal Prod.	$7.1	2.1%	$3.4	1.1%	$8.3	2.0%	$12.1	2.8%
Wholesale -Durables	$4.9	1.5%	$10.6	3.3%	$18.6	4.5%	$17.3	4.1%
Wholesale -Non-Durables	$3.7	1.1%	$5.3	1.6%	$7.5	1.8%	$2.8	0.7%
Stone,Clay,Glass,Concrete	$4.9	1.5%	$3.8	1.2%	$2.9	0.7%	$1.7	0.4%
Local and Suburban Transit	$5.4	1.6%	$0.0	0.0%	$7.2	1.7%	$9.8	2.3%
Subtot. Major Low-Tech	$119.5	35.9%	$100.8	31.2%	$132.3	32.0%	$108.9	25.6%
Subtot. All Ohter Industries	$82.3	24.7%	$80.5	24.9%	$75.4	18.3%	$94.3	22.2%
Grand Total	$332.7	100.0%	$322.9	100.0%	$412.9	100.0%	$425.5	100.0%

INDUSTRY DISTRIBUTION
SBIC CALENDAR 1979 FINANCINGS
($ in thousands)

SIC	TITLE	AMOUNT	% OF $
35	Machinery, except Electrical	39515.9	14.1
54	Food Stores	17852.1	6.4
15	General Building Contractors	15583.3	5.6
48	Communication	15000.5	5.4
73	Business Services	13620.9	4.9
65	Real Estate	12313.4	4.4
36	Electric aad Electronic Equipment	11120.1	4.0
58	Eating and Drinking Places	9732.2	3.5
38	Instruments and Related Products	9540.7	3.4
13	Oil and Gas Extraction	8991.7	3.2
80	Health Services	8590.1	3.1
34	Fabricated Metal Products	7237.3	2.6
45	Transportation by Air	6560.0	2.3
50	Wholesale Trade-Durable Goods	6368.3	2.3
27	Printing and Publishing	6031.8	2.2
70	Hotels and Other Lodging Places	5961.5	2.1
28	Chemicals and Allied Products	5705.7	2.0
41	Local and Interurban Passenger Transit	5069.4	1.8
51	Wholesale Trade-Nondurable Goods	4972.6	1.8
30	Rubber and Misc. Plastics Products	4594.6	1.6
55	Automotive Dealers & Service Stations	4486.6	1.6
59	Miscellaneous Retail	3968.9	1.4
20	Food and Kindred Products	3647.5	1.3
42	Trucking and Warehousing	3291.2	1.2
32	Stone, Clay, and Glass Products	3290.2	1.2
89	Miscellaneous Services	3088.2	1.0
99	Non-Classifiable Establishments	2831.1	1.0
75	Auto Repair, Services, and Garages	2792.5	1.0
79	Amusement & Recreations Services	2782.6	1.0
37	Transportation Equipment	2606.6	.9
52	Building Materials & Garden Supplies	2494.4	.9
23	Apparel and Other Textile Products	2486.9	.9
39	Miscellaneous Manufacturing Industries	2315.3	.8
16	Heavy Contruction Contractors	2224.9	.8
67	Holding and Other Investment Offices	1988.5	.7
56	Apparel and Accessory Stores	1894.5	.7
82	Educational Services	1708.5	.6
17	Special Trade Contractors	1660.9	.6
26	Paper and Allied Products	1084.7	.4
10	Metal Mining	1005.9	.4
64	Insurance Agents, Brokers & Service	971.6	.3
29	Petroleum and Coal Products	961.1	.3
25	Furniture and Fixtures	925.9	.3

SIC	TITLE	AMOUNT	% OF $
44	Water Transportation	851.8	.3
57	Furniture and Home Furnishings Stores	784.2	.3
78	Motion Pictures	762.7	.3
24	Lumber and Wood Products, except Furniture	720.3	.3
53	General Merchandise Stores	680.9	.2
40	Railroad Transportation	671.9	.2
31	Leather and Leather Products	668.0	.2
7	Agricultural Services	638.9	.2
9	Fishing, Hunting, and Trapping	583.0	.2
72	Personal Services	528.5	.2
2	Agricultural Production-Livestock	504.0	.2
12	Bituminous Coal and Lignite Mining	455.1	.2
14	Non-Metallic Minerals, except Fuels	413.7	.1
49	Electric, Gas, and Sanitary Services	381.0	.1
22	Textile Mill Products	355.0	.1
47	Transportation Services	255.6	.1
76	Miscellaneous Repair Services	217.0	.1
1	Agricultural Production-Crops	199.5	.1
61	Credit Agencies Other Than Banks	185.1	.1
81	Legal Services	175.0	.1
86	Membership Organizations	155.0	.1
83	Social Services	111.3	0
63	Insurance Carriers	103.5	0
33	Primary Metal Industries	100.0	0
62	Security, Commodity Brokers & Services	96.9	0
84	Museums, Botanical, Zoological Gardens	10.0	0
8	Forestry	5.0	0
11	Anthracite Mining	0	0
21	Tobacco Manufactures	0	0
43	U.S. Postal Service	0	0
46	Pipe Lines, except Natural Gas	0	0
60	Banking	0	0
66	Combined Real Estate, Insurance, Etc.	0	0
88	Private Households	0	0
	TOTAL	279533.5	

TABLE #18

INDUSTRY DISTRIBUTION
CALENDAR 1981 SBIC FINANCING

($ in millions)

SIC	DESCRIPTION	$ AMOUNT	% $	CUMMULATIVE $ AMOUNT	CUMMUL. %
36	Electrical&Electronic Mach.	35.5	10.67	35.5	10.67
35	Machinery(Incl. computers)	32.3	9.71	67.8	20.38
13	Oil and Gas Extraction	30.3	9.11	98.1	29.49
73	Business Services	20.3	6.10	118.4	35.59
15	Building Construction	20.2	6.07	138.6	41.66
48	Communication	20.2	6.07	158.8	47.73
38	Instruments&Related Products	14.9	4.48	173.7	52.21
54	Food Stores	13.4	4.03	187.1	56.24
58	Restaurants	11.1	3.34	198.2	59.58
65	Real Estate	11.0	3.34	209.2	62.92
80	Health Services	7.7	2.31	216.9	65.23
20	Food Manufacturing	7.5	2.25	224.4	67.48
34	Fabricated Metal Products	7.1	2.13	231.5	69.61
41	Local & Suburban Transit	5.4	1.62	236.9	71.23
50	Wholesale Trade-Durables	4.9	1.47	241.8	72.70
32	Stone,Clay,Glass, & Concrete	4.9	1.47	246.7	74.17
51	Wholesale Trade-Nondurables	3.7	1.11	250.4	75.28
	Fifty-four other industries	82.3	24.72	332.7	100.00

TABLE #18

INDUSTRY DISTRIBUTION
CALENDAR 1982 SBIC FINANCING

($ in millions)

SIC	DESCRIPTION	$ AMOUNT	% $	CUMMULATIVE $ AMOUNT	CUMMUL. %
35	Machinery(Incl. computers)	37.8	11.71	37.8	11.71
36	Electircal & Electronic Mach.	33.8	10.47	71.6	22.18
48	Communications	25.4	7.87	97.0	30.05
13	Oil and Gas Extraction	25.2	7.81	122.2	37.86
73	Business Services	16.6	5.14	138.8	43.00
15	Building Construction	15.6	4.83	154.4	47.83
38	Instruments&Related Products	14.8	4.58	169.2	52.41
54	Food Stores	10.9	3.38	180.1	55.79
50	Wholesale Trade-Durable	10.6	3.28	190.7	59.07
58	Restaurants	9.0	2.79	199.7	61.86
65	Real Estate	7.0	2.17	206.7	64.03
80	Health Services	6.7	2.07	213.4	66.10
37	Transportation Equipment	6.6	2.04	220.0	68.14
28	Chemicals and Allied Products	6.5	2.01	226.5	70.15
59	Misc. Retail	5.9	1.83	232.4	71.98
51	Wholesale Trade-Nondurables	5.3	1.64	237.7	73.62
27	Printing and Publishing	5.0	1.55	242.7	75.17
45	Transportation by Air	4.6	1.42	247.3	76.59
20	Food Manufacturing	4.1	1.27	251.4	77.86
32	Stone,Clay,Glass & Concrete	3.8	1.18	255.2	79.04
34	Fabricated Metal Products	3.4	1.05	258.6	80.09
	Forty-eight other industries	64.3	19.91	322.9	100.00

Compare to 1972

1983 FINANCINGS

7/6/84

ST CODE	AMOUNT	% OF TOTAL	CUM %
✓35	$63,284,050	0.153270	0.153270
✓36	$50,692,510	0.122774	0.276045
✓73	$28,053,137	0.067943	0.343988
✓48	$26,636,763	0.064512	0.408501
✓50	$18,562,104	0.044956	0.453458
✓13	$17,308,792	0.041921	0.495379
✓58	$15,145,085	0.036680	0.532060
✓54	$14,127,275	0.034215	0.566275
✓80	$13,454,499	0.032586	0.598861
✓38	$12,627,445	0.030583	0.629444
✓15	$11,137,364	0.026974	0.656418
✓28	$10,505,376	0.025443	0.681862
✓[illegible]	$8,368,[illegible]	0.020268	0.702131
✓34	$8,332,873	0.020181	0.722313
✓59	$7,933,138	0.019213	0.741526
✓20	$7,837,260	0.018981	0.760508
✓51	$7,535,219	0.018249	0.778758
✓41	$[illegible]	0.017525	0.796284
99	$6,848,109	0.016585	0.812869
✓65	$[illegible]	0.014717	0.827587
✓[illegible]	$5,470,8[illegible]	0.013250	0.840837
✓67	$4,975,050	0.012049	0.852886
[illegible]	$3,991,126	0.009666	0.862553
27	$3,664,441	0.008875	0.871428
75	$3,642,201	0.008821	0.880249
79	$3,621,505	0.008771	0.889020
53	$3,017,746	0.007308	0.896329
✓32	$2,924,490	0.007082	0.903411
55	$2,908,450	0.007044	0.910456
56	$2,712,566	0.006569	0.917025
39	$2,278,727	0.005518	0.922545
57	$2,175,010	0.005267	0.927813
4[illegible]	$2,172,132	0.005260	0.933073
[illegible]	$2,052,8[illegible]	0.004971	0.938045
70	$2,040,456	0.004941	0.942987
52	$1,913,955	0.004635	0.947623
17	$1,796,600	0.004351	0.951974
14	$1,759,000	0.004260	0.956234
43	$1,758,000	0.004257	0.960491
45	$1,607,939	0.003894	0.964386
63	$1,250,000	0.003027	0.967414
72	$1,230,961	0.002981	0.970395
1	$1,135,000	0.002748	0.973144
24	$1,082,700	0.002622	0.975766
89	$1,082,449	0.002621	0.978388
47	$1,027,550	0.002488	0.980877
33	$1,014,980	0.002458	0.983335
76	$857,010	0.002075	0.985410
10	$802,500	0.001943	0.987354
7	$735,100	0.001780	0.989134
62	$500,000	0.001210	0.990345
60	$460,000	0.001114	0.991459
78	$435,000	0.001053	0.992513
25	$435,000	0.001053	0.993567
44	$378,000	0.000915	0.994482
64	$335,700	0.000813	0.995295
85	$284,389	0.000688	0.995984
31	$283,282	0.000686	0.996670
8[illegible]	$250,000	0.000605	0.997275
16	$214,000	0.000518	0.997794
8[illegible]	$210,000	0.000508	0.998302
61	$150,000	0.000363	0.998666
2	$130,000	0.000314	0.998980
87	$100,000	0.000242	0.999223
29	$96,021	0.000232	0.999455
40	$85,200	0.000206	0.999662
2[illegible]	$80,000	0.000193	0.999855
9	$21,500	0.000052	0.999907
66	$15,000	0.000036	0.999944
81	$13,235	0.000032	0.999976
0	$9,780	0.000023	1
TOTAL	$412,890,289		

Calendar 1984

SIC Classification	Number	Dollar Amount
1 Agricultural prod-crops	6	855,000
2 Agricultural prod-livestock	2	90,500
3 03	0	0
4 04	0	0
5 05	0	0
6 06	0	0
7 Agricultural services	9	909,800
8 Forestry	2	186,000
9 Fishing & hunting	2	112,000
10 Metal mining	1	750,000
11 Anthracite mining	0	0
12 Bituminous coal mining	0	0
13 Oil & Gas Extraction	34	10,935,260
14 Mining of nonmetals	4	200,000
15 Building construction	92	11,217,687
16 Construction not building	11	2,420,374
17 Construction-special trade	22	2,284,102
18 18	0	0
19 19	0	0
20 Food & kindred products	38	5,022,993
21 Tobacco manufactures	1	32,500
22 Textile mill products	4	1,010,000
23 Apparel from fabrics	12	1,205,929
24 Wood products-except furnitu	6	2,200,174
25 Furniture & fixtures	8	6,432,060
26 Paper & allied products	6	1,193,524
27 Printing & publishing	45	15,807,919
28 Chemicals & allied product	39	7,348,776
29 Petroleum refining	5	1,025,098
30 Rubber & plastic prod	33	3,796,215
31 Leather & related	6	1,749,159
32 Stone,glass & concrete	18	1,747,295
33 Primary metal industry	14	2,194,915
34 Fabricated metal prod	48	12,085,479
35 Machinery except electrical	330	52,809,335
36 Electrical & electronic mach	291	52,576,895
37 Transportation equipment	8	685,121
38 Measuring instruments	154	20,687,887
39 Miscellaneous manufacturing	15	2,153,779
40 Railroad transportation	7	1,021,664
41 Local & suburban transit	246	9,771,581
42 Motor freight	13	1,839,779
43 U.S. Postal Service	2	2,786,868
44 Water transportation	9	1,477,848
45 Transportation by air	14	1,078,032
46 Pipe lines except gas	0	0
47 Transportation services	9	375,048
48 Communication	114	34,968,130
49 Electric & gas services	8	1,206,812
50 Wholesale trade-durable	122	17,294,084
51 Wholesale trade-nondurable	29	2,781,547
52 Building materials & hardwar	7	700,075
53 General merchandise stores	7	1,685,067
54 Food stores	160	14,272,284
55 Auto dealers & gas stations	21	2,493,000
56 Apparel stores	10	622,770
57 Furniture & equipment stores	10	878,000
58 Eating & drinking places	82	11,524,095
59 Miscellaneous retail	61	7,377,788

61 Credit agencies not banks	2	75,000
62 Security brokers & dealers	9	1,423,946
63 Insurance	1	20,000
64 Insurance agents	6	326,113
65 Real estate	21	3,917,581
66 Combos of r.e.,insurance & 1	0	0
67 Investment offices	7	1,696,513
68 68	0	0
69 69	0	0
70 Hotels & lodging	10	1,113,500
71 71	0	0
72 Personal services	26	2,032,813
73 Business services	245	38,169,851
74 74	0	0
75 Auto repair & garages	23	2,988,300
76 Miscellaneous repair service	10	609,340
77 77	0	0
78 Motion pictures	14	1,868,996
79 Amusement & recreation servi	30	5,928,297
80 Health services	85	15,688,559
81 Legal services	3	440,000
82 Educational services	7	978,333
83 Social services	1	30,000
84 Museums & art galeries	0	0
85 85	0	0
86 Membership organizations	0	0
87 87	0	0
88 Private households	1	26,621
89 Miscellaneous services	38	9,025,371
90 90	0	0
91 91	0	0
92 92	0	0
93 93	0	0
94 94	0	0
95 95	0	0
96 96	0	0
97 97	0	0
98 98	0	0
99 Nonclassified	19	3,308,763
TOTAL	2,755	425,548,145

SIC Group	Number	Dollar Amount
Agri.,Forestry,Fisheries	21	2,153,300
Mining	39	11,885,260
Construction	125	15,922,163
Mfg. - Durable Goods	892	153,572,940
Mfg. - Nondurable Goods	189	38,192,113
Trans.,Comm.,Utilities	422	54,525,762
Wholesale Trade	151	20,075,631
Retail Trade	358	39,553,079
Fin.,Ins.,Real Estate	46	7,459,153
Services	493	78,899,981
Unclassified	19	3,308,763
TOTAL	2,755	425,548,145

Page 1 SBICs Report For Calendar 1983

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
0045	0	0	0	0	1	9,780	1	9,780
0161	0	0	1	250,000	0	0	1	250,000
0172	1	30,000	0	0	0	0	1	30,000
0181	2	55,000	1	396,500	1	103,500	4	555,000
0189	0	0	0	0	1	300,000	1	300,000
0241	1	15,000	0	0	0	0	1	15,000
0272	1	115,000	0	0	0	0	1	115,000
0711	1	450,000	0	0	0	0	1	450,000
0731	1	4,100	0	0	0	0	1	4,100
0742	2	265,000	0	0	0	0	2	265,000
0782	1	16,000	0	0	0	0	1	16,000
0913	1	21,500	0	0	0	0	1	21,500
1044	0	0	0	0	1	750,000	1	750,000
1081	0	0	0	0	1	52,500	1	52,500
1300	0	0	1	55,687	1	24,503	2	80,190
1311	3	414,625	15	2,134,500	22	6,715,258	40	9,264,383
1330	0	0	2	1,000,000	2	2,839,873	4	3,839,873
1381	3	115,000	1	75,000	1	1,008,414	5	1,198,414
1382	0	0	0	0	5	1,050,000	5	1,050,000
1389	5	1,067,688	4	714,490	2	93,754	11	1,875,932
1422	1	1,425,000	0	0	0	0	1	1,425,000
1442	0	0	4	50,000	0	0	4	50,000
1481	0	0	1	284,000	0	0	1	284,000
1514	0	0	0	0	1	760,000	1	760,000
1521	9	194,784	6	703,500	1	152,500	16	1,050,784
1522	7	760,359	4	780,000	0	0	11	1,540,359
1531	31	3,264,471	18	2,656,250	1	436,500	50	6,357,221
1541	0	0	2	269,000	0	0	2	269,000
1542	1	150,000	3	822,220	0	77,780	4	1,050,000
1552	2	110,000	0	0	0	0	2	110,000
1611	3	147,500	0	0	0	0	3	147,500
1623	1	6,500	0	0	0	0	1	6,500
1699	1	60,000	0	0	0	0	1	60,000
1711	2	36,000	0	0	0	0	2	36,000
1721	1	65,000	1	45,000	0	0	2	110,000
1731	1	20,000	3	271,000	2	38,600	6	329,600
1734	1	110,000	0	0	0	0	1	110,000
1742	1	100,000	0	0	0	0	1	100,000
1743	3	140,000	0	0	0	0	3	140,000
1752	1	145,000	0	0	0	0	1	145,000
1771	1	20,000	0	0	0	0	1	20,000
1774	1	60,000	0	0	0	0	1	60,000
1780	1	65,000	0	0	0	0	1	65,000
1794	0	0	2	140,000	0	0	2	140,000
1798	0	0	1	615,000	0	0	1	615,000
1799	1	26,000	1	25,000	0	0	2	51,000
2002	0	0	1	100,000	0	0	1	100,000
2011	1	70,000	2	575,000	0	0	3	645,000
2024	3	85,000	0	0	0	0	3	85,000
2026	4	2,770,000	0	0	0	0	4	2,770,000
2034	1	10,000	1	502,500	1	157,250	3	669,750
2041	1	2,300,000	0	0	0	0	1	2,300,000
2051	2	137,500	0	0	0	0	2	137,500
2065	0	0	2	195,000	0	0	2	195,000
2086	1	250,000	0	0	0	0	1	250,000

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
2096	1	160,000	0	0	0	0	1	160,000
2099	1	100,000	2	425,010	0	0	3	525,010
2211	1	400,000	0	0	0	0	1	400,000
2253	2	225,000	1	54,000	0	0	3	279,000
2261	1	75,000	0	0	0	0	1	75,000
2272	0	0	1	2,000,000	0	4,314,871	1	6,314,871
2281	0	0	1	1,000,000	0	300,000	1	1,300,000
2321	1	30,000	2	3,000,000	0	12,500	3	3,042,500
2327	0	0	0	0	3	270,008	3	270,008
2339	2	134,750	0	0	0	0	2	134,750
2341	1	50,000	0	0	0	0	1	50,000
2345	2	180,000	1	25,000	0	0	3	205,000
2372	0	0	0	0	1	740	1	740
2392	2	270,000	0	0	0	0	2	270,000
2395	1	18,128	0	0	0	0	1	18,128
2439	1	27,000	0	0	0	0	1	27,000
2472	0	0	1	750,000	0	0	1	750,000
2499	3	26,000	0	0	13	279,700	16	305,700
2511	1	50,000	0	0	0	0	1	50,000
2519	1	40,000	0	0	0	0	1	40,000
2521	1	25,000	0	0	0	0	1	25,000
2542	1	20,000	0	0	0	0	1	20,000
2599	0	0	0	0	1	300,000	1	300,000
2621	0	0	0	0	2	80,000	2	80,000
2711	1	148,000	2	525,000	2	92,875	5	765,875
2720	4	71,000	2	42,000	1	330,000	7	443,000
2721	0	0	2	146,000	2	270,000	4	416,000
2722	1	95,791	0	0	0	0	1	95,791
2735	0	0	1	250,000	0	10,000	1	260,000
2741	2	80,000	0	0	0	0	2	80,000
2751	1	12,587	0	0	1	300,000	2	312,587
2752	3	777,000	1	168,000	0	0	4	945,000
2754	1	70,000	0	0	0	0	1	70,000
2761	0	0	0	0	1	75,045	1	75,045
2782	0	0	0	0	1	47,143	1	47,143
2789	1	110,000	0	0	0	0	1	110,000
2791	0	0	1	44,000	0	0	1	44,000
2800	0	0	2	150,000	0	150,000	2	300,000
2812	0	0	2	1,950,000	0	0	2	1,950,000
2815	3	161,000	1	150,000	2	93,000	6	404,000
2819	0	0	1	129,000	3	1,489,000	4	1,618,000
2820	0	0	0	0	1	6,500	1	6,500
2821	0	0	0	0	1	4,400	1	4,400
2830	0	0	0	0	2	999,990	2	999,990
2831	0	0	0	0	9	1,162,250	9	1,162,250
2833	1	9,000	0	0	1	112,500	2	121,500
2834	2	490,000	0	0	9	1,435,914	11	1,925,914
2843	1	75,322	0	0	0	0	1	75,322
2844	1	7,500	0	0	0	0	1	7,500
2851	1	75,000	2	1,000,000	0	400,000	3	1,475,000
2869	0	0	0	0	1	35,000	1	35,000
2873	1	100,000	0	0	0	0	1	100,000
2879	0	0	1	100,000	1	200,000	2	300,000
2898	0	0	0	0	1	20,000	1	20,000
2931	0	0	1	96,021	0	0	1	96,021

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
3045	0	0	1	370,000	0	0	1	370,000
3060	0	0	1	680,000	0	15,941	1	695,941
3070	0	0	0	0	1	400,000	1	400,000
3079	10	287,000	13	3,467,000	3	250,882	26	4,004,882
3149	2	114,630	0	0	0	0	2	114,630
3175	0	0	0	0	4	69,652	4	69,652
3198	1	99,000	0	0	0	0	1	99,000
3241	0	0	1	120,000	0	30,000	1	150,000
3271	1	1,250,000	0	0	0	0	1	1,250,000
3272	3	151,793	0	0	0	0	3	151,793
3281	1	25,925	0	0	0	0	1	25,925
3295	17	647,000	0	0	1	20,000	18	667,000
3296	0	0	1	162,000	0	18,000	1	180,000
3298	0	0	4	374,772	0	0	4	374,772
3299	0	0	0	0	1	125,000	1	125,000
3312	1	75,000	0	0	0	0	1	75,000
3321	0	0	0	0	1	140,000	1	140,000
3322	0	0	1	200,000	0	0	1	200,000
3335	1	50,000	0	0	1	149,980	2	199,980
3369	2	400,000	0	0	0	0	2	400,000
3412	0	0	0	0	3	1,602,000	3	1,602,000
3429	2	200,000	1	100,000	0	0	3	300,000
3430	0	0	2	75,000	0	0	2	75,000
3433	1	60,000	1	28,065	0	1,935	2	90,000
3442	0	0	0	0	1	42,757	1	42,757
3444	0	0	0	0	1	700,000	1	700,000
3446	0	0	2	865,920	0	50,000	2	915,920
3448	1	1,000,000	0	0	0	0	1	1,000,000
3449	0	0	0	0	1	900	1	900
3469	2	470,000	0	0	0	0	2	470,000
3471	4	302,311	1	90,000	0	0	5	392,311
3473	0	0	0	0	1	19,500	1	19,500
3479	0	0	5	470,000	1	110,400	6	580,400
3490	4	750,000	1	300,000	4	405,022	9	1,455,022
3494	0	0	2	39,053	0	0	2	39,053
3496	0	0	1	500,010	0	0	1	500,010
3499	0	0	1	150,000	0	0	1	150,000
3513	0	0	0	0	1	180,000	1	180,000
3523	2	311,250	0	0	0	0	2	311,250
3530	0	0	2	535,375	0	600	2	535,975
3531	0	0	1	12,364	0	0	1	12,364
3533	1	1,300,000	2	732,500	4	156,609	7	2,189,109
3540	0	0	2	1,700,000	1	803,500	3	2,503,500
3541	0	0	0	0	4	549,976	4	549,976
3542	3	405,000	0	0	0	0	3	405,000
3544	4	398,882	1	280,000	0	0	5	678,882
3545	0	0	1	500,000	0	0	1	500,000
3546	0	0	1	400,000	0	100,000	1	500,000
3549	0	0	0	0	1	500,000	1	500,000
3550	1	48,279	1	40,000	0	0	2	88,279
3554	2	170,000	0	0	0	0	2	170,000
3555	4	105,000	1	9,000	1	12,583	6	126,583
3559	1	326,400	0	0	3	1,251,000	4	1,577,400
3561	0	0	0	0	1	12,500	1	12,500
3562	1	500,000	0	0	0	0	1	500,000

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
3569	1	40,000	0	0	1	225,000	2	265,000
3570	0	0	1	250,062	4	1,166,562	5	1,416,624
3572	0	0	0	0	1	21,214	1	21,214
3573	19	1,784,246	28	4,632,737	156	42,754,091	203	49,171,074
3574	1	50,000	0	0	0	0	1	50,000
3576	0	0	0	0	1	75,000	1	75,000
3579	0	0	0	0	4	349,520	4	349,520
3585	1	50,000	0	0	0	0	1	50,000
3589	1	25,000	0	0	0	0	1	25,000
3599	0	0	3	475,000	1	44,800	4	519,800
3600	4	184,600	0	0	2	232,000	6	416,600
3612	1	17,450	0	0	2	6,852	3	24,302
3613	0	0	0	0	1	44,375	1	44,375
362	0	0	0	0	1	220,000	1	220,000
3621	0	0	4	430,000	0	60,000	4	490,000
3622	1	112,800	6	427,064	1	58,000	8	597,864
3629	0	0	0	0	3	1,468,754	3	1,468,754
3634	1	60,000	2	115,000	0	0	3	175,000
3641	0	0	1	300,000	0	0	1	300,000
3651	0	0	0	0	1	104,570	1	104,570
3652	0	0	2	125,000	1	200,000	3	325,000
3661	3	55,500	9	1,085,625	22	3,649,626	34	4,790,751
3662	8	255,000	7	3,100,000	14	2,299,168	29	5,654,168
3664	0	0	0	0	1	120,000	1	120,000
3665	2	130,000	0	0	5	427,999	7	557,999
3670	5	414,113	1	37,100	46	9,406,722	52	9,857,935
3671	0	0	1	93,750	1	112,449	2	206,199
3672	0	0	0	0	1	500,000	1	500,000
3673	0	0	1	1,250,000	0	0	1	1,250,000
3674	0	0	3	269,600	52	10,894,873	55	11,164,473
3675	4	619,862	0	0	1	258,621	5	878,483
3678	0	0	2	406,230	1	102,515	3	508,745
3679	20	1,004,500	10	1,315,638	11	4,392,948	41	6,713,086
3693	1	7,300	0	0	2	465,000	3	472,300
3698	2	458,000	5	1,035,460	9	971,638	16	2,465,098
3699	0	0	2	450,000	7	936,808	9	1,386,808
3714	1	65,000	0	0	0	0	1	65,000
3715	0	0	1	200,000	1	60,000	2	260,000
3724	1	30,000	1	30,000	0	20,500	2	80,500
3728	1	277,500	1	555,000	0	0	2	832,500
3731	1	21,500	0	0	0	0	1	21,500
3753	0	0	1	36,000	0	24,000	1	60,000
3769	0	0	1	133,333	1	600,000	2	733,333
3811	2	26,850	4	275,000	13	1,890,643	19	2,192,493
3812	0	0	1	277,376	0	299	1	277,675
3813	1	100,000	0	0	0	0	1	100,000
3815	0	0	1	40,000	2	615,992	3	655,992
3823	4	318,957	12	1,287,818	9	1,680,004	25	3,286,779
3825	2	400,000	1	150,060	4	672,154	7	1,222,214
3829	2	167,000	4	441,650	4	128,522	10	737,172
3832	7	260,900	4	60,000	1	1,400	12	322,300
3841	1	25,000	3	272,382	9	1,507,303	13	1,804,685
3842	3	368,800	1	100,000	3	726,655	7	1,195,455
3843	0	0	0	0	2	225,000	2	225,000
3845	0	0	0	0	1	7,280	1	7,280

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
3861	1	200,000	2	300,000	2	100,400	5	600,400
3911	1	10,000	0	0	0	0	1	10,000
3923	0	0	0	0	1	75,000	1	75,000
3944	0	0	0	0	1	500,000	1	500,000
3949	0	0	0	0	1	50,001	1	50,001
3961	1	8,400	0	0	0	0	1	8,400
3993	1	38,000	0	0	0	0	1	38,000
3998	1	250,000	3	376,730	1	25,000	5	651,730
3999	4	738,700	0	0	1	206,896	5	945,596
4020	1	85,200	0	0	0	0	1	85,200
4100	3	235,000	7	837,400	0	0	10	1,072,400
4119	4	205,392	2	210,000	0	0	6	415,392
4121	76	5,498,453	0	0	0	0	76	5,498,453
4142	2	250,000	0	0	0	0	2	250,000
4212	2	744,132	2	297,000	0	0	4	1,041,132
4213	1	53,000	1	1,000,000	0	0	2	1,053,000
4231	0	0	2	78,000	0	0	2	78,000
4400	1	188,000	0	0	0	0	1	188,000
4454	1	32,000	0	0	0	0	1	32,000
4469	2	78,000	1	80,000	0	0	3	158,000
4500	0	0	1	333,333	1	304,833	2	638,166
4511	0	0	12	667,666	3	192,107	15	859,773
4521	2	110,000	0	0	0	0	2	110,000
4712	2	50,000	0	0	1	25,000	3	75,000
4713	2	28,000	0	0	0	0	2	28,000
4722	0	0	2	120,200	0	9,800	2	130,000
4783	0	0	1	1,500,000	0	0	1	1,500,000
4789	0	0	0	0	1	25,000	1	25,000
4811	4	240,000	1	40,000	20	7,071,723	25	7,351,723
4825	0	0	4	2,615,550	1	3,475	5	2,619,025
4830	0	0	3	646,800	0	0	3	646,800
4832	10	544,266	26	5,287,368	4	1,629,676	40	7,461,310
4833	0	0	2	800,000	4	1,597,500	6	2,397,500
4899	2	196,000	22	2,977,782	11	2,986,623	35	6,160,405
4925	0	0	1	50,000	0	0	1	50,000
4931	0	0	0	0	1	574,050	1	574,050
4952	1	120,000	0	0	0	0	1	120,000
4953	3	283,500	0	0	0	0	3	283,500
5008	2	594,010	6	500,000	0	166,800	8	1,260,810
5010	2	23,740	0	0	0	0	2	23,740
5012	0	0	1	100,000	1	180,000	2	280,000
5013	23	500,635	1	111,000	0	0	24	611,635
5014	0	0	1	100,000	0	0	1	100,000
5023	1	750,000	0	0	0	0	1	750,000
5031	0	0	0	0	1	97,500	1	97,500
5041	1	40,000	0	0	0	0	1	40,000
5042	0	0	1	550,000	1	125,000	2	675,000
5051	1	275,000	1	450,000	1	370,000	3	1,095,000
5060	4	480,000	0	0	3	2,609,250	7	3,089,250
5063	2	65,000	2	1,900,000	1	2,500,100	5	4,465,100
5064	1	550,000	0	0	0	0	1	550,000
5065	0	0	2	90,000	5	44,986	7	134,986
5081	4	923,333	3	478,000	4	1,740,490	11	3,141,823
5084	2	181,161	0	0	1	350,000	3	531,161
5086	1	20,000	2	290,000	2	54,999	5	364,999

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
5087	3	237,600	0	0	0	0	3	237,600
5092	1	110,000	0	0	0	0	1	110,000
5093	2	95,000	0	0	0	0	2	95,000
5094	2	850,000	1	58,500	0	0	3	908,500
5113	1	50,000	0	0	0	0	1	50,000
5122	2	88,411	0	0	3	425,000	5	513,411
5131	0	0	1	65,000	0	0	1	65,000
5136	1	30,000	0	0	0	0	1	30,000
5137	3	244,000	2	1,271,000	0	100,000	5	1,615,000
5138	0	0	2	500,000	0	10	2	500,010
5140	3	305,000	0	0	1	50,000	4	355,000
5145	0	0	1	70,000	0	30,000	1	100,000
5149	1	37,500	0	0	0	0	1	37,500
5153	0	0	0	0	1	500,000	1	500,000
5154	0	0	0	0	1	310,000	1	310,000
5161	2	77,698	1	71,000	0	0	3	148,698
5180	0	0	1	173,600	0	18,400	1	192,000
5181	0	0	1	452,083	0	47,917	1	500,000
5182	1	96,000	0	0	1	1,909,600	2	2,005,600
5190	0	0	0	0	1	119,000	1	119,000
5191	0	0	1	115,000	1	200,000	2	315,000
5199	3	175,000	1	4,000	0	0	4	179,000
5211	2	550,000	2	21,314	2	1,041,641	6	1,612,955
5261	2	57,000	1	113,000	1	6,000	4	176,000
5271	1	125,000	0	0	0	0	1	125,000
5311	0	0	1	100,000	0	30,000	1	130,000
5331	4	200,368	2	1,466,655	1	193,345	7	1,860,368
5399	0	0	0	0	3	1,027,378	3	1,027,378
5401	2	275,369	0	0	0	0	2	275,369
5410	12	482,553	0	0	0	0	12	482,553
5411	88	11,628,468	26	1,274,500	0	21,667	114	12,924,635
5423	1	25,000	0	0	0	0	1	25,000
5441	1	85,000	0	0	0	0	1	85,000
5462	4	120,000	1	34,000	0	0	5	154,000
5499	2	180,718	0	0	0	0	2	180,718
5511	4	1,136,000	1	75,000	0	0	5	1,211,000
5521	5	324,300	0	0	0	0	5	324,300
5531	0	0	2	200,000	0	0	2	200,000
5541	5	893,153	1	255,000	0	0	6	1,148,153
5599	0	0	0	0	1	25,000	1	25,000
5600	0	0	2	90,000	2	202,900	4	292,900
5611	5	879,666	0	0	1	250,000	6	1,129,666
5621	4	705,000	1	200,000	1	270,000	6	1,175,000
5631	0	0	1	75,000	0	0	1	75,000
5661	1	40,000	0	0	0	0	1	40,000
5712	1	50,000	4	1,400,000	0	0	5	1,450,000
5719	0	0	0	0	2	80,000	2	80,000
5732	4	245,000	1	400,010	0	0	5	645,010
5800	2	135,000	1	45,042	0	0	3	180,042
5812	65	8,911,645	29	3,680,833	7	1,614,065	101	14,206,543
5813	8	481,500	0	0	0	0	8	481,500
5845	1	100,000	0	0	0	0	1	100,000
5890	1	99,000	0	0	0	0	1	99,000
5892	0	0	2	78,000	0	0	2	78,000
5912	2	717,326	0	0	0	0	2	717,326

SIC Code	Debt Only Num	Debt Only Dollars	Debt/Equity Num	Debt/Equity Dollars	Equity Only Num	Equity Only Dollars	Total Financing Num	Total Financing Dollars
5921	9	779,200	4	629,000	0	100,000	13	1,508,200
5932	1	35,000	0	0	0	0	1	35,000
5941	0	0	1	35,000	0	0	1	35,000
5943	0	0	1	80,000	0	0	1	80,000
5944	1	30,000	0	0	0	0	1	30,000
5945	1	60,000	0	0	0	0	1	60,000
5946	3	225,273	0	0	0	0	3	225,273
5947	3	160,000	0	0	0	0	3	160,000
5961	1	25,000	0	0	1	1,150	2	26,150
5962	0	0	0	0	1	500,000	1	500,000
5963	0	0	0	0	1	900,000	1	900,000
5982	1	9,500	0	0	0	0	1	9,500
5992	5	457,580	1	103,000	0	0	6	560,580
5995	3	104,788	1	75,000	1	24,000	5	203,788
5999	26	1,319,313	6	465,000	2	1,098,008	34	2,882,321
6044	0	0	0	0	1	300,000	1	300,000
6049	0	0	0	0	1	60,000	1	60,000
6083	0	0	0	0	1	100,000	1	100,000
6162	0	0	1	25,000	0	0	1	25,000
6163	1	125,000	0	0	0	0	1	125,000
6211	0	0	1	200,000	0	0	1	200,000
6221	3	300,000	0	0	0	0	3	300,000
6331	0	0	0	0	1	925,000	1	925,000
6359	1	120,000	0	0	0	0	1	120,000
6361	0	0	0	0	1	60,000	1	60,000
6371	1	145,000	0	0	0	0	1	145,000
6411	4	180,700	2	140,300	0	14,700	6	335,700
6511	1	68,000	0	0	0	0	1	68,000
6512	1	65,000	1	110,000	1	6,000	3	181,000
6513	1	60,000	1	200,000	0	0	2	260,000
6531	9	756,692	3	312,000	4	390,000	16	1,458,692
6552	18	1,516,994	12	2,216,711	3	265,367	33	3,999,072
6599	1	110,000	0	0	0	0	1	110,000
6611	1	15,000	0	0	0	0	1	15,000
6711	0	0	5	2,315,000	0	0	5	2,315,000
6723	1	150,000	0	0	0	0	1	150,000
6748	1	77,050	0	0	0	0	1	77,050
6771	0	0	2	2,333,000	0	0	2	2,333,000
6792	1	100,000	0	0	0	0	1	100,000
7011	11	623,789	1	100,000	2	1,266,667	14	1,990,456
7041	0	0	0	0	1	50,000	1	50,000
7212	1	45,494	0	0	0	0	1	45,494
7215	6	338,000	0	0	0	0	6	338,000
7216	1	30,000	0	0	1	16,667	2	46,667
7217	1	119,000	0	0	0	0	1	119,000
7219	1	52,500	0	0	0	0	1	52,500
7221	1	110,000	0	0	0	0	1	110,000
7231	3	110,500	1	43,000	0	0	4	153,500
7251	0	0	1	250,000	0	0	1	250,000
7276	0	0	0	0	1	100,000	1	100,000
7299	1	15,000	0	0	1	800	2	15,800
7310	0	0	1	25,000	0	0	1	25,000
7331	0	0	0	0	2	189,352	2	189,352
7333	5	100,389	0	0	1	183,761	6	284,150
7349	2	35,000	1	25,000	0	0	3	60,000

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
7361	2	125,000	2	67,000	0	0	4	192,000
7370	0	0	1	400,065	0	0	1	400,065
7372	6	704,727	20	2,120,433	67	12,592,551	93	15,417,711
7374	0	0	0	0	10	1,762,518	10	1,762,518
7379	6	432,277	3	1,091,687	3	344,991	12	1,868,955
7389	0	0	2	430,300	3	634,998	5	1,065,298
7391	1	40,000	1	50,000	18	1,612,479	20	1,702,479
7392	8	795,000	3	452,000	2	199,750	13	1,446,750
7393	0	0	1	250,000	0	0	1	250,000
7394	0	0	10	300,000	0	0	10	300,000
7395	5	349,847	1	35,000	2	110,000	8	494,847
7398	2	200,000	1	150,000	2	194,112	5	544,112
7399	13	451,050	7	247,450	11	1,351,400	31	2,049,900
7512	0	0	1	100,000	0	0	1	100,000
7523	1	65,000	0	0	0	0	1	65,000
7531	1	30,000	4	486,000	0	0	5	516,000
7535	1	185,000	0	0	0	0	1	185,000
7538	2	170,000	2	118,000	0	0	4	288,000
7539	6	735,000	0	0	0	0	6	735,000
7542	3	687,500	0	0	0	0	3	687,500
7550	0	0	0	0	1	800,001	1	800,001
7572	1	140,700	0	0	0	0	1	140,700
7641	2	45,000	0	0	0	0	2	45,000
7699	2	12,000	3	800,010	0	0	5	812,010
7812	1	70,000	0	0	0	0	1	70,000
7814	1	27,500	0	0	0	0	1	27,500
7819	1	75,000	1	240,000	0	0	2	315,000
7824	0	0	0	0	1	22,500	1	22,500
7900	0	0	0	0	1	6,000	1	6,000
7922	0	0	1	275,000	0	0	1	275,000
7948	0	0	1	200,000	0	0	1	200,000
7949	1	57,000	0	0	0	0	1	57,000
7980	0	0	0	0	1	1,000,000	1	1,000,000
7993	5	389,000	0	0	0	0	5	389,000
7996	0	0	1	100,000	0	0	1	100,000
7997	2	142,000	0	0	2	800,000	4	942,000
7999	1	40,000	3	600,005	1	12,500	5	652,505
8011	6	200,710	1	150,000	0	0	7	350,710
8015	1	89,742	0	0	0	0	1	89,742
8021	4	623,878	0	0	1	250,000	5	873,878
8041	1	16,700	0	0	0	0	1	16,700
8042	10	314,000	0	0	0	0	10	314,000
8045	1	46,000	1	11,500	0	0	2	57,500
8051	2	485,000	1	80,000	1	5,363	4	570,363
8059	1	75,000	0	0	0	0	1	75,000
8060	0	0	0	0	2	1,068,914	2	1,068,914
8062	0	0	0	0	1	700	1	700
8063	0	0	1	1,000,000	0	0	1	1,000,000
8071	3	339,895	0	0	4	703,000	7	1,042,895
8072	0	0	1	500,000	0	0	1	500,000
8079	0	0	0	0	1	112,500	1	112,500
8081	1	150,000	1	100,000	2	437,000	4	687,000
8091	1	190,846	5	1,697,899	2	2,652,101	8	4,540,846
8098	0	0	0	0	1	900,001	1	900,001
8099	0	0	0	0	3	1,253,750	3	1,253,750

SIC	Debt Only		Debt/Equity		Equity Only		Total Financing	
Code	Num	Dollars	Num	Dollars	Num	Dollars	Num	Dollars
8111	1	13,235	0	0	0	0	1	13,235
8299	0	0	1	60,000	1	150,000	2	210,000
8351	1	250,000	0	0	0	0	1	250,000
8599	0	0	2	284,389	0	0	2	284,389
8742	1	100,000	0	0	0	0	1	100,000
8911	1	12,640	2	241,680	3	51,418	6	305,738
8922	0	0	0	0	1	40,000	1	40,000
8932	1	40,000	0	0	0	0	1	40,000
8980	1	25,000	2	48,673	1	271,685	4	345,358
8999	1	251,525	0	0	1	99,828	2	351,353
9999	6	1,754,819	10	3,307,054	8	1,786,236	24	6,848,109
TOTAL	999	100,942,003	629	117,273,144	836	194,675,142	2,464	412,890,289

12. b. What percentage of the venture capital market do SBICs represent?

Answer:

SBA does not measure the total venture capital market, in fact, there are few reliable estimates of its dimensions.

From available sources we estimate that between 5% and 15% of the total disbursements would come from SBICs depending upon what cyclical phase the general economy would be in at a particular point in time.

12. c. What is the loss rate in this program?

Answer:

Attached is a table that reconciles SBIC leverage as of the end of fiscal years 1982, 1983, and 1984.

Actual chargeoffs through September 1984 were $34.2 million or 1.7% of the total of $2.0 billion ever disbursed by SBA to SBICs and Section 301(d) SBICs. There is another $205.0 million or 10% of the $2.0 billion which is in liquidation status. If SBA eventually charges off 50% or $102.5 million of that amount, combined with the $34.2 million the total actual losses would be $136.7 million or 6.6% of the $2.0 billion disbursed.

SBIC Disbursements - Calendar Year 1984
Four-digit Concentrations $4.0 mill. & Over

SIC	Industry Description	$ Amount	%	Obvious Hi-Tech.	Possible Hi-Tech
1311	Crude Petroleum and Natural Gas	$6,483,850	1.5%		
1521	Gen. Contractors (Single Family Homes)	$4,910,142	1.2%		
2512	Wood Household Furniture	$4,000,360	0.9%		
2751	Commercial Printing(Letterpress,Screen)	$4,368,483	1.0%		
2752	Commercial Printing(Lithographic)	$4,030,000	0.9%		X
3573	Electronic Computing Equipment	$38,651,932	9.1%	X	
3661	Telephone and Telegraph Apparatus	$4,105,401	1.0%	X	
3662	Radio&TV Trans.,Signalling,and Detection	$5,970,465	1.4%	X	
3670	Electronic Components&Accessories	$4,865,180	1.1%	X	
3674	Semiconductors and Related Devices	$7,841,426	1.8%	X	
3679	Electronic Components (NEC)	$10,308,353	2.4%	X	
3826	Measuring and Controlling Instruments	$6,044,518	1.4%	X	
4121	Taxi-Cabs	$7,761,931	1.8%		
4830	Radio and TV Broadcasting	$10,104,000	2.4%		X
4832	Radio Broadcasting	$13,454,013	3.2%		X
4899	Communications Services(NEC)	$6,356,676	1.5%	X	
5411	Grocery Stores	$11,916,084	2.8%		
5812	Eating Places	$10,018,239	2.4%		
7372	Computer Programming&Software	$16,866,396	4.0%	X	
7379	Computer Related Services	$4,153,224	1.0%	X	
7389	Misc. Business Services	$4,855,372	1.1%		X
8081	Outpatient Care Facilities	$4,100,000	1.0%	X	
8980	Services (NEC)	$6,160,549	1.4%		
		$197,326,594	46.4%		
	All Other Classifications	$228,221,551	53.6%		
	Total SBIC Disbursements-1984	$425,548,145	100.0%		

Note: In the All Other Classifications
There is Also Some Hi-Tech Financing

Reconciliation of SBIC Leverage
Fiscal Years 1982/1983/1984

	As of 9/30/82			As of 9/30/83			As of 9/30/84		
	Percent	($thousands)	Percent	Percent	($thousands)	Percent	Percent	($thousands)	Percent
Total Disbursed	100.0%	$1,692,984		100.0%	$1,839,890		100.0%	$2,059,300	
Minus:									
Total Chargeoff	1.9%	$32,953		1.8%	$33,157		1.7%	$34,168	
Total Repaid	31.5%	$532,881		34.5%	$635,201		39.1%	$804,782	
Equals: Total Outstanding	66.6%	$1,127,150	100.0%	63.7%	$1,171,532	100.0%	59.3%	$1,220,350	100.0%
Minus:									
Cases in Port.Mgmt.	10.9%	$184,877	16.4%	9.8%	$180,593	15.4%	10.0%	$205,007	16.8%
Active SBICs	45.8%	$775,071	68.8%	44.9%	$825,345	70.5%	41.2%	$847,628	69.5%
Active MESBICs	9.4%	$158,937	14.1%	9.7%	$178,359	15.2%	8.9%	$182,790	15.0%
Equals: Statistical Lag	0.5%	$8,265	0.7%	-0.7%	($12,765)	-1.1%	-0.7%	($15,075)	-1.2%

13. In December 1982, the Committee held oversight hearings on the SBIC program. Since that time, what has happened to the amount of technical violations in the program?

Answer:

The Inspector General of SBA must report to Congress on its activities on a semi-annual basis. SBA has analysed the findings listed in those reports for the past five years through FY 1984.

Attached is a table and some charts that summarize those reports. These data show a general decline in findings of the Inspector General.

In one significant category, Excessive Interest Rates, the findings have gone up but these are not actual violations. These are potential violations that occur on indexed or variable rate debt financings where although the current rate is below SBA's maximum, there is a potential only for the rate to exceed the maximum should the index base increase significantly. SBA has requested SBICs to cure this potential by placing an absolute ceiling on its indexed or variable rate debt financings. We expect compliance and cooperation from the industry in this respect.

Data Source: Inspector Gen.
Semi-Annual Reports

	FY 1980 No.SBICs	%	FY 1981 No.SBICs	%	FY 1982 No.SBICs	%	FY 1983 No.SBICs	%	FY 1984 No.SBICs	%
Number of SBICs Examined	411	100.0%	460	100.0%	453	100.0%	448	100.0%	476	100.0%
# without Signif. Find.	243	59.1%	243	52.8%	268	59.2%	281	62.7%	320	67.2%
# with Signif. Find.	168	40.9%	217	47.2%	185	40.8%	167	37.3%	156	32.8%
By Type of Signif.Find.										
# with Conflicts of Int.	74	18.0%	85	18.5%	60	13.2%	59	13.2%	52	10.9%
# with Control Situations	27	6.6%	42	9.1%	61	13.5%	52	11.6%	34	7.1%
# with Overlines	45	10.9%	51	11.1%	55	12.1%	55	12.3%	44	9.2%
# with Excess Int.Rates	57	13.9%	71	15.4%	42	9.3%	48	10.7%	59	12.4%
# with Proh.Use of Funds	28	6.8%	35	7.6%	n/a	0.0%	30	6.7%	32	6.7%
# with Activ.Not Contemp.	38	9.2%	53	11.5%	48	10.6%	40	8.9%	38	8.0%

Violation Information	1980 # Find.	%	1981 # Find.	%	1982 # Find.	%	1983 # Find.	%	1984 # Find.	%
Findings (Possible Viol.)	861	100.0%	1993	100.0%	2714	100.0%	2474	100.0%	2312	100.0%
Non-Significant	541	62.8%	1330	66.7%	2073	76.4%	1836	74.2%	1535	66.4%
Significant	320	37.2%	663	33.3%	641	23.6%	638	25.8%	777	33.6%
Type of Significant										
Conflicts of Int.	96	11.1%	197	9.9%	175	6.4%	238	9.6%	165	7.1%
Control Situations	40	4.6%	63	3.2%	91	3.4%	91	3.7%	55	2.4%
Ove-lines	49	5.7%	82	4.1%	73	2.7%	100	4.0%	81	3.5%
Excess Int. Rate	60	7.0%	170	8.5%	93	3.4%	95	3.8%	260	11.2%
Prohib.Use Funds	32	3.7%	41	2.1%	26	1.0%	44	1.8%	106	4.6%
Act. Not Contemp.	43	5.0%	110	5.5%	119	4.4%	70	2.8%	110	4.8%

SBIC REGULATORY
STATUS

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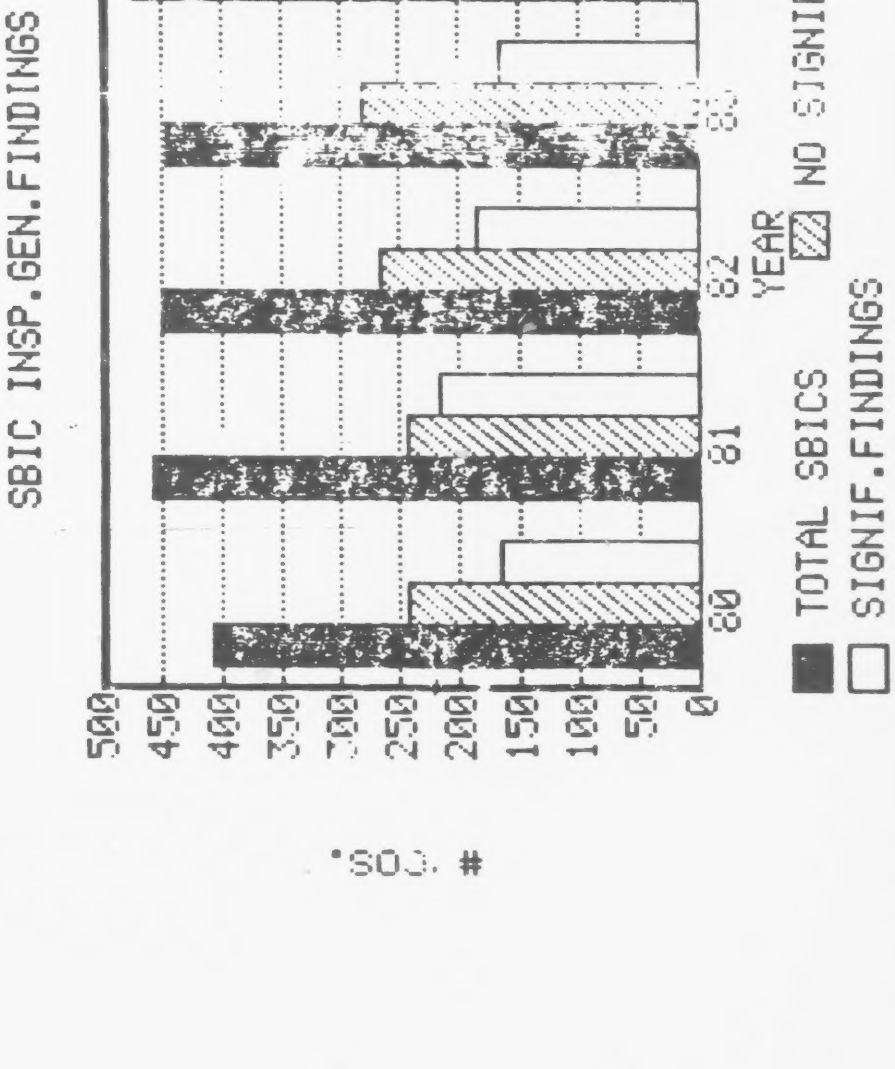
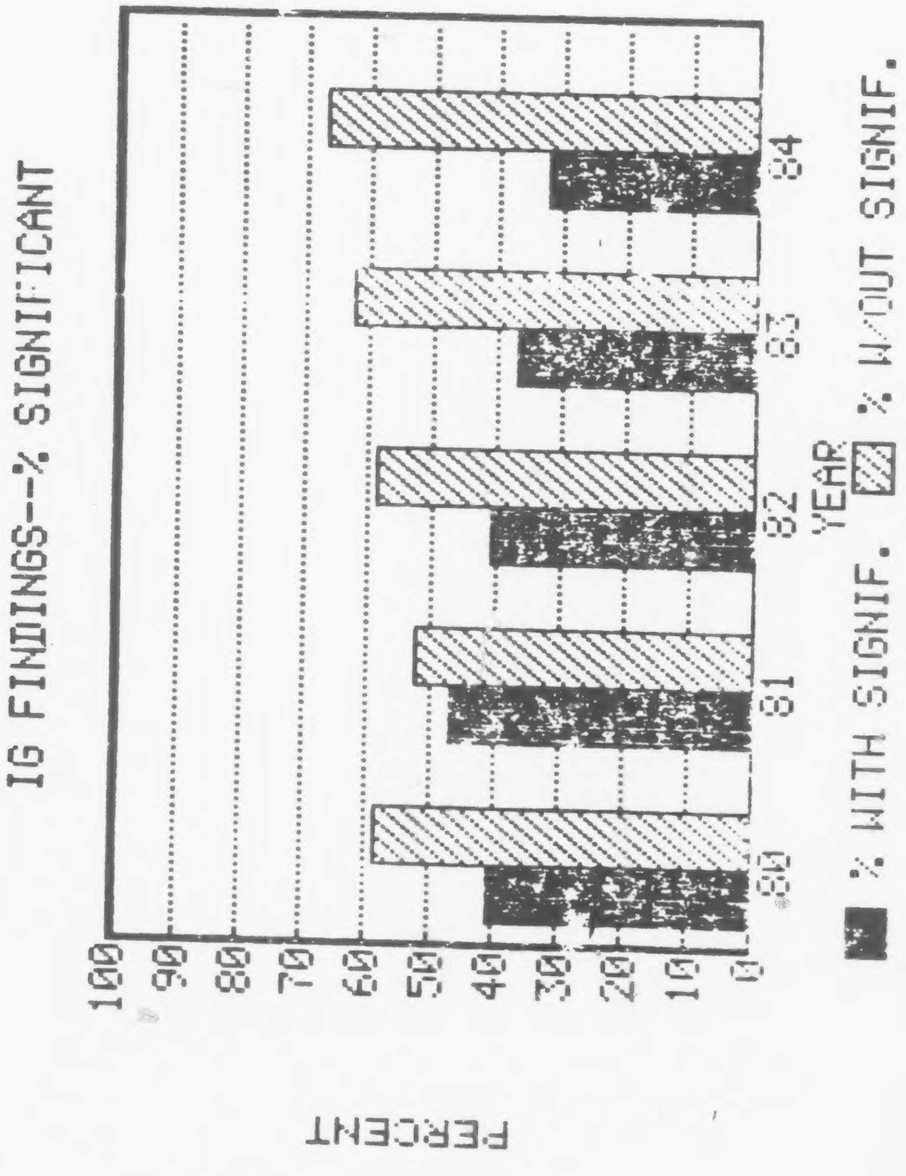
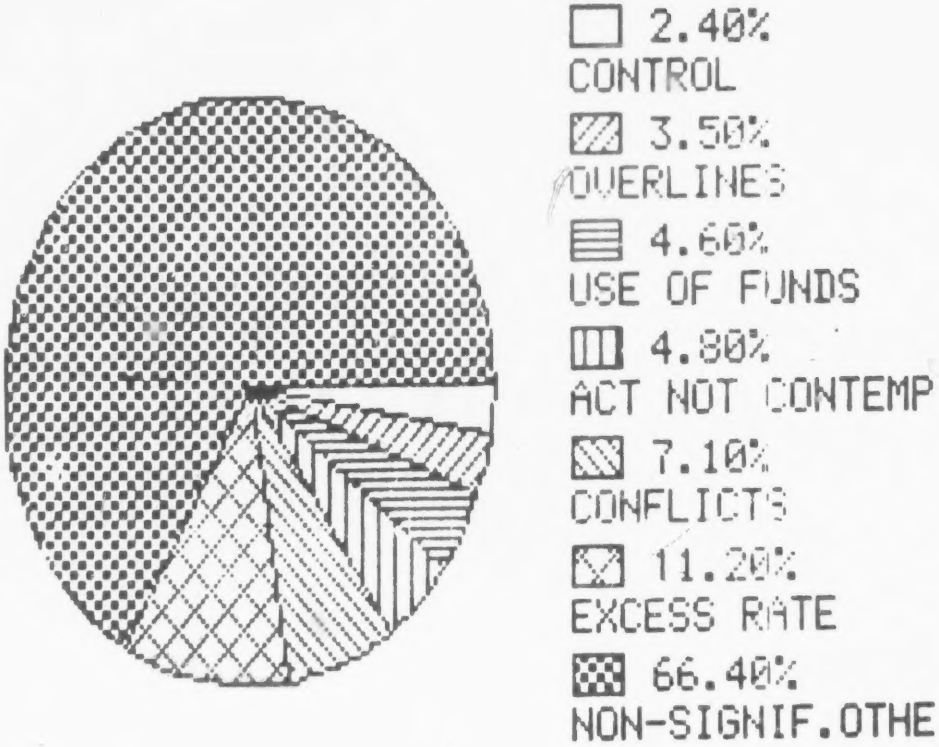
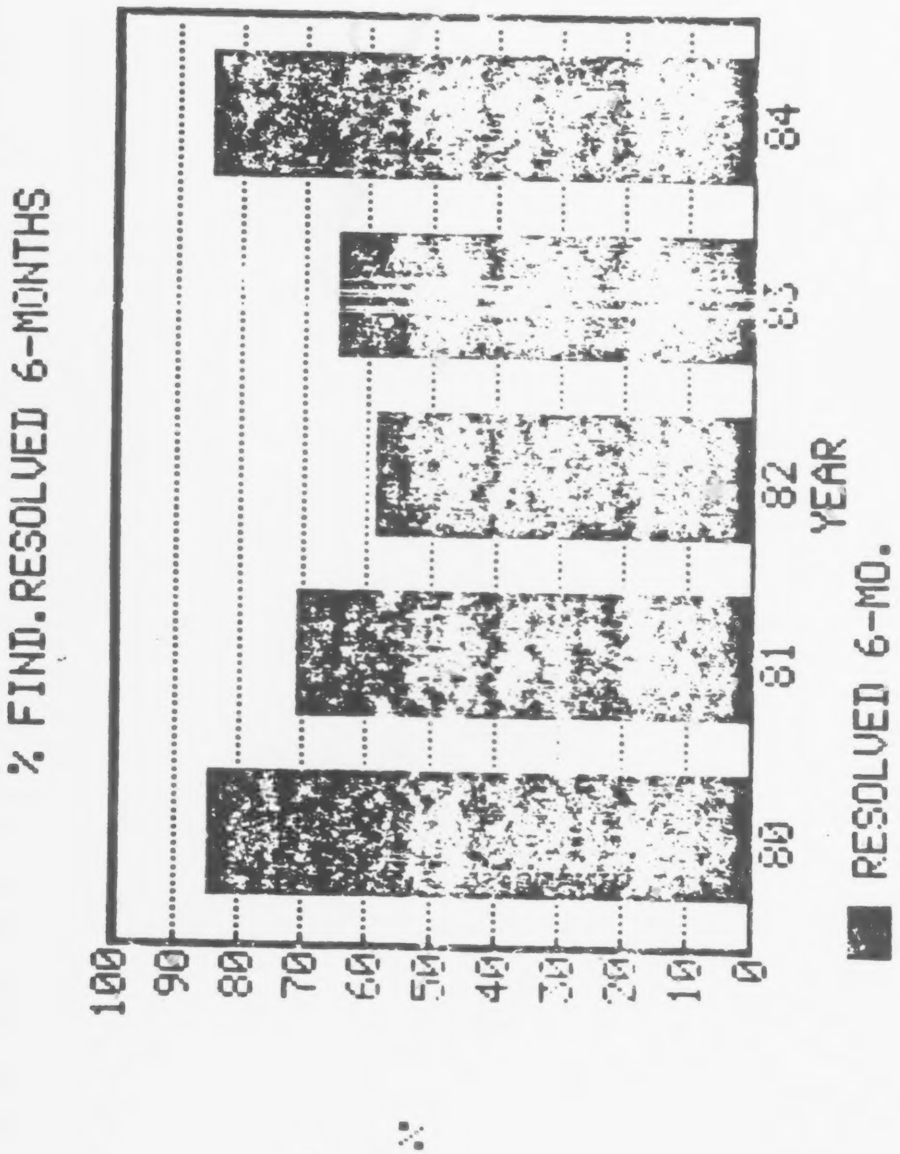
(1) SBIC INSPECTOR GENERAL FINDINGS
(2) I G FINDINGS-PERCENT SIGNIFICANT
(3) DISTRIBUTION OF FINDINGS BY TYPE
(4) PERCENT FINDINGS RESOLVED IN 6-MO.
(5) RESOLVING ALLEG. VIOLATIONS

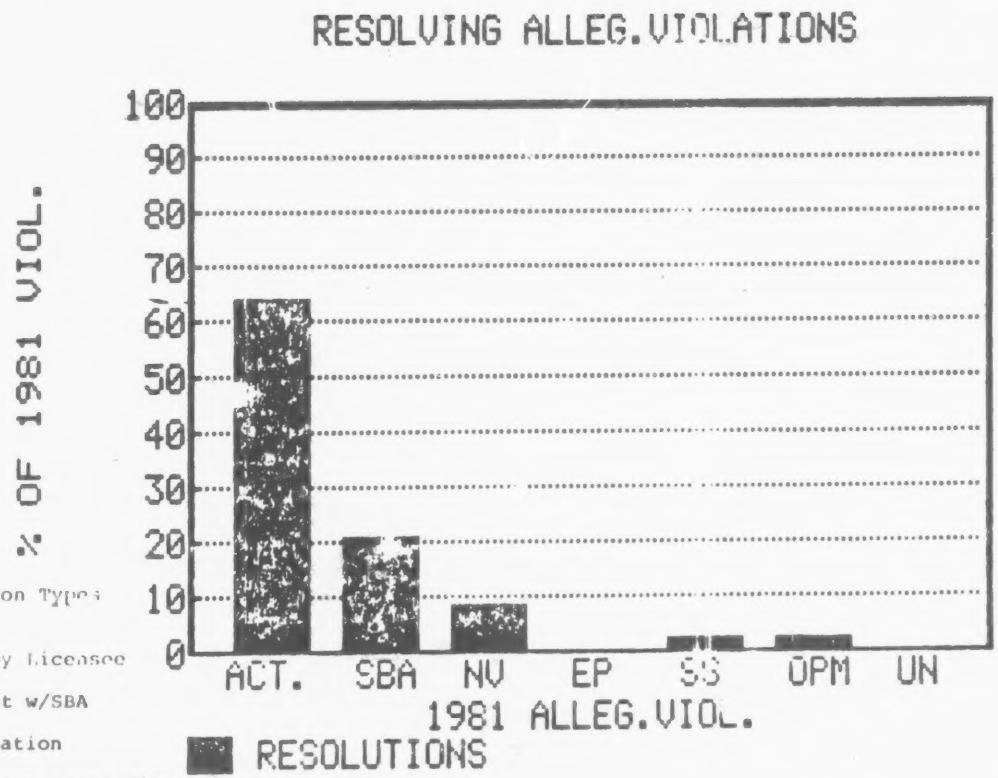

SBIC INSP.GEN.FINDINGS
# OCS.
500
450
400
350
300
250
200
150
100
50
0
80
81
82
83
84
YEAR
TOTAL SBICS
SIGNIF.FINDINGS
NO SIGNIF.FIND.


IG FINDINGS--% SIGNIFICANT
PERCENT
100
90
80
70
60
50
40
30
20
10
0
80
81
82
83
84
YEAR
% WITH SIGNIF.
% W/OUT SIGNIF.

DISTRIBUTION OF VIOLATIONS




% FIND.RESOLVED 6-MONTHS
100
90
80
70
60
50
40
30
20
10
0
%
80
81
82
83
84
YEAR
RESOLVED 6-MO.



ey to Resolution Types

CT. = Action by Licensee
BA = Agreement w/SBA
V = Not Violation
P = Enforcement Preceeding
S = Surrender/Settlement
PM = Portfolio Mgmt. (Liquidation)
N = Unresolved

14. Mr. Administrator, since 1980, SBA has aggressively promoted the section 503 program as an effective economic development tool.

a. How many development companies have been certified by SBA?

Answer: As of September 30, 1984, there were 532 CDCs in the program. In addition, 19 other companies had been certified but surrendered their certificate or were decertified.

b. Who are the Board of Directors of these Development Companies?

Answer: They are members of the CDC and are representative of the CDCs area of operation. Each CDC has at least 5 directors and one is from a private lending institution. This insures an active board with at least one member who has credit and commercial lending experience.

Although not presently required, many CDCs have all 4 groups represented on the board that are required in the membership. They are Government, financial institutions, business organizations, and community organizations. Most CDCs have three of the four groups represented.

c. SBA's maximum share of a "503" project is 40 percent. Who picks up the rest?

Answer: Usually private sector lending institutions provide 50% of the project cost and the CDC or the small business concern provide the remaining 10%.

Our experience in the program over the last 4 years shows a slightly different mix of participation in projects as follows:

Private Sector Financing	48%
503 Debenture (503 guaranteed)	36%
Other Financing	3%
CDC/SBC Injections	13%
Total	100%

d. Would banks be willing to make long term fixed rate financing to these businesses without the 503 program?

Answer: No. SBA Regulations (Section 108.503-6(a)) states that "Application for financial assistance will not be accepted for processing and no assistance may be extended unless the 503 company can demonstrate to the satisfaction of SBA that the desired financing is not available from non-Federal sources on reasonable terms." Accordingly, the 503 loan application requires the CDC to obtain a letter from the participating lender stating the reasons why it will not finance the entire project. Then, the loan officer makes an assessment as to whether funds are available on reasonable terms.

e. How many 503 loans have been approved and what is the total dollar amount of these loans?

Answer: During the 4 years the program has been in existance (10/1/80 - 9/30/84), 3,533 loans have been approved totaling $703.7 million.

f. How many jobs have been created or retained due to this program?

Answer: We estimate that the 3,533 projects when completed will have created or retained 95,000 job opportunities. This represents an investment of $7,600 per job (one job opportunity for every $7,600 of 503 debenture proceeds).

g. What has been the actual loss rate in this job creation program?

Answer: To date, the Small Business Administration has not repurchased any 503 Development Company loans, and therefore, has not incurred any losses.

QUESTION 15(a)	What would be the impact on the borrower of increasing, as some suggest, the guarantee fee from 1 percent to 2 percent? To 5 percent? What in your judgment would be the program effect of such increases?
ANSWER	The impact upon the small business borrower is most graphically measured by assuming that the increase in fees is financed by increasing the size of the loan by an amount equal to the fee, and then noting the resulting percentage increase in monthly payments. It is a common practice in many financial sectors to finance up-front fees or "points" in this way. For a typical SBA loan, the percentage increase in monthly payments for a 2 percent fee would be 0.88 percent (Table). The increase would be 3.42 percent for a 5 percent fee.
	In our judgment the program would not be adversely affected to a severe extent with an increase to 2 percent. However, we believe there could be serious adverse program implications on the demand side if the increase was to 5 percent. We would need experience factors at 2 percent before being able to assess any greater increases.
QUESTION 15(b)	How much in additional funds would be generated?
ANSWER	Given the same guaranteed program level as appropriated in FY 1985, the total receipts to the Agency from guaranteed fees would increase from approximately $20 million to $40 million using a 2 percent rate, or to $100 million using a 5 percent rate.
	Of course, the increase in the fee would ultimately be passed on to the borrower. Based on an average loan size of $171,063 and the current interest rate of 13.25% (N.Y. Prime + 2.75%) and an average maturity of 9 years, the borrower's monthly payment would increase from $2,719 at 1% to 2,743 at 2% and 2,812 at 5%.

TABLE

Impact Upon Borrower of Increasing Fees

Fee	Loan Size ($) ($)	Monthly Payment	% increase in Monthly Payment compared to 1% Fee (%)
Current 1% fee	171,063	2,719	
2% fee	172,517	2,743	+0.88
5% fee	176.879	2,812	+3.42

NOTE: Calculations assume:

1. Fee increase financed by increasing loan size by amount equal to fee increase.

2. Loan size = average guaranteed loan size in FY 1984.

3. Term = 9 years, average term for 7(a) guaranteed loans.

4. Interest rate = 13.25%, composed of 10.5% (New York prime on February 6, 1985) + 2.75% maximum allowable add on.

QUESTION 16(a).

What has been the effect of reducing the percentage of guarantee from 90 percent to 75 percent in the preferred lenders program? Should this change be enacted across the board as a way of increasing a bank's exposure and improving the quality of loans?

ANSWER

It is difficult to specifically identify the effect of the lower guarantee percentage on the preferred lenders program. The program is still too new to form conclusions based on experience. However, the lower guarantee percentage is one of the cornerstones on which the program is based. SBA decided to give approval authority to lenders only for those loans with the lower guarantee (loans of $100,000 or less which require a 90 percent guarantee are not eligible for PLP) as the Agency feels that the lower guarantee will lead to better credits and more thorough servicing by the participating lender. It should be noted that PLP lenders have had CLP and the regular 7(a) program available for those in which the lender did not want to accept a 75 percent guarantee.

If the 75 percent guarantee were enacted across the board, the lender's exposure would increase and portfolio quality would probably improve. Such a move would eliminate some lenders and borrowers but should allow SBA to continue serving most of its existing clientele.

QUESTION 16(b)

From a program point of view, what in your judgment would be the effect of reducing the percentage of guarantee from 90 percent to 80 percent in the regular 7(a) general business loan program?

ANSWER

In our judgment we would still have a viable loan guarantee program if we reduced the percentage of guarantee from 90 percent to 80 percent. There is no question that some lenders would lose interest and drop out of the program if the percentage of guarantee is dropped below 90 percent. Those lenders, in particular, that rely heavily on the secondary market would not find the 80 percent guarantee as attractive as the 90 percent guarantee. At the same time, our experience suggests that the guarantee program would still be regarded by lenders as a valuable tool in their small business lending efforts. We believe that there would be healthy demand and a viable loan guarantee program at the 80 percent guarantee level.

ADDITIONAL QUESTIONS FOR THE RECORD FROM SENATOR BOREN

Question #1: Has Congress in the past ever defined what acceptable loan loss limits should be for SBA? We hear so many conflicting statements concerning SBA's loss rate, I wonder what the actual loss rate is for the guaranteed loan program? Would you be agreeable to working with Congress to help set acceptable limits for the future?

Answer #1(a): No.

(b): Based on the FY 1984 Loss Study, the actual loss rate for the guaranteed loan program is 5.72%.

(c): We have no problem participating in any effort that would result in an improvement of the guaranteed program.

Question #2: Mr. Sanders, as you may or may not know I am co-sponsor of S.408 and hope very much that we can persuade the Administration to leave the Small Business Administration intact. However, the SBA is not without some efficiency problems. For example, in Region 6 there are, as I understand it, 11 district offices for 5 states. The only problem is that 7 of those offices are in 1 state. Mr. Sanders the Oklahoma City district office currently is staffed by 29 people, down from a high of 45. They are responsible for administering a loan portfolio in excess of 4,600 loans. That is approximately 159 loans per person. Of the 7 offices in Texas only 2 offices are as efficient as the Oklahoma City office. The Oklahoma District Director was told to close down the branch office in Tulsa so that those personnel slots could be sent to El Paso where they currently have 17 staff members and a loan portfolio of 959 - or approximately 56 loans per person. It is also my understanding that Regional Director Reynaldo Lopez has 5 special assistants all at the GS-13 level or higher - Mr. Sanders do you realize how many clerk-typists or loan processors those GS points could provide? I would also like for you to check with your staff and report back on the travel budgets for all Regional Directors. At a time when SBA should be providing maximum service to individuals, I have a sneaking suspicion that we are spending too much money on administrative details. Mr. Sanders I am very willing to go to bat for SBA with the Administration, but you have got to help us. If Region 6 is any indication of how SBA's resources are being allocated then we have some very basic restructuring to do.

Answer: Regional Administrators are responsible for distributing ceiling allocations between offices based on workload and other requirements. Many of the offices in the State of Texas have been established over the years as a result of major disaster declarations. Although the Oklahoma District Office has 29 full-time permanent employees, only 9 of these employees are responsible for maintaining the regular business portfolio. As stated above, there are 29 employees on-board; however, the ceiling is currently 31 positions. The current portfolio in the Oklahoma D.O. is 4,712 loans, of which 3,543 are disaster loans, therefore, 1,169 loans are serviced by the 9 regular employees or an average portfolio of 130 per person. This is below the Regional average of 164. The remaining 3,543 disaster loans are serviced by 3 temporary Disaster Servicing employees for an average portfolio of 1,181. This compares to an average disaster portfolio workload of 1,030. It becomes very difficult to compare one office to the next due to demographics, make-up of loan portfolio between those in-liquidation status and those that are current, employee distribution between professional, para-professional and clerical etc. Chart II reflects the individual average workload within all 11 offices throughout the Dallas Region.

Question #2: (Continued)

The Regional Administrator of Dallas presently has only 2 special assistants which is consistent with other regional offices. The third person with the title of special assistant is responsible for the international trade function.

El Paso's regular business portfolio is serviced by 4 employees at an average portfolio of 210 loans per person. In addition, they have a disaster portfolio of over 34,000 loans that are currently being serviced by 28 temporary disaster servicing personnel at an average portfolio of 1,221 per employee.

According to our records, as of April 30, 1980, the Oklahoma District Office had 43 full-time employees. That is the highest number of employees in the past 5 years. The total employment for the Dallas Region was 497. As a result of the Administration's efforts to reduce the federal budget deficit and inflated employment levels, the SBA has lost close to 500 full-time employees over the past four to five years.

All travel funds for Regional Administrators are funded to an activity "Executive Direction-Field." These funds are not for the exclusive use by the Regional Administrator. They are sub-allocated to District and Branch Offices, and must take care of the traveling requirements of the District Directors and Branch Managers and other employees in Executive Direction, the Public Information Officers, Advocates, etc. The following reflects the number of employees currently on-board in Executive Direction, the total yearly travel allotment, and the average per employee.

CHART I

	Executive Direction Travel	# of Positions in Ex. Dir.	$ Available Per Person
I	$40,000	21	$1,905
II	38,000	28	1,357
III	40,000	37	1,081
IV	76,000	31	2,452
V	85,000	30	2,833
VI	76,000	30	2,533
VII	64,000	18	3,555
VIII	62,000	18	3,444
IX	110,000	30	3,666
X	57,000	13	4,385
	$648,000	256	$2,531

Question #2 (Continued)

CHART II

	On-Board 1/31/85 Portfolio Management Regular	On-Board 1/31/85 Portfolio Management Disaster	Portfolio As of 1/31/85 Regular	Portfolio As of 1/31/85 Disaster	Portfolio As of 1/31/85 Total	Regular Portfolio Per Person	Disaster Portfolic Per Persor
Dallas	12	2	1,966	2,967	4,933	164	1,484
Alburquerque	11	1	1,278	926	2,204	116	926
Corpus Christi	4	3	663	2,086	2,749	166	695
El Paso	4	28	839	34,174	35,013	210	1,221
Houston	15	3	2,234	1,571	3,805	149	524
Little Rock	8	2	1,119	2,737	3,856	140	1,369
Lower Rio Grande Valley	7	3	1,310	2,995	4,305	187	998
Lubbock	9	7	1,870	7,116	8,986	208	1,017
New Orleans	13	4	1,958	2,382	4,340	151	596
Oklahoma	9	3	1,169	3,543	4,712	130	1,181
San Antonio	9	5	2,130	2,349	4,479	237	470
Total	101	61	16,536	62,846	79,382	164	1,030

THE SMALL BUSINESS ADMINISTRATION:
ITS RECORD OF ACCOMPLISHMENTS

Prepared by the Staff of the Senate
Committee on Small Business

SBA: A LEGISLATIVE OVERVIEW

Section 202 of Public Law 163 well states the policy of Congress which led to the establishment of the Small Business Administration:

> The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect insofar as is possible, the interests of small-business concerns in order to preserve free-competitive enterprise...

These reasons supporting the original Congressional authorization of the SBA still hold true today.

The Committee has engaged in a strong course of oversight of the agency and its programs, and its Chairman, Senator Lowell Weicker, Jr., R-Conn., and Ranking Member, Senator Dale Bumpers, D-Ark., are of the opinion that the agency is fulfilling its mandate, and serving those it is intended to serve.

Accordingly, Senators Weicker and Bumpers have introduced legislation, co-sponsored by 7 other Committee Members, charting a three-year course for the agency, while achieving substantial savings through a budget freeze and program eliminations. The bill is consistent with the Committee's interest in paring down the agency; in 1981 Congress eliminated 27 percent of its operating budget.

This bill represents a legislative response to the Administration's proposal to dismantle the agency, and makes a clear statement by its sponsors that the starting point for any Senate deliberations with regard to the agency's funding will be this legislation, and not the Administration's budget submission. The Weicker-Bumpers bill contains the following key provisions:

- maintains SBA as an independent agency by authorizing funding for SBA programs and activities for the next three fiscal years;
- freezes all programs in FY 86 at FY 85 levels;
- eliminates all direct lending programs, except for loans to the handicapped, veterans, and Minority Enterprise Small Business Investment Companies (MESBICs);
- achieves total agency cost reductions from CBO's current policy baseline of $661.3 million in budget authority and $722.6 million in outlays over the next three fiscal years.

SBA: A MISSION FULFILLED

The SBA has an impressive record of providing critical assistance to large numbers of small business owners and operators. The agency's role in maintaining a viable and progressive small business sector, and creating an economic climate conducive to individual initiative and opportunity, is demonstrated by its accomplishments:

- The 7(a) Guarantee Lending Program has resulted in 500,000 small business loans, a majority of them long-term, totalling $36 billion. These loans helped fill a well documented long-term credit gap for small businesses.

- SBA, through its Small Business Investment Company (SBIC) and Minority Enterprise Small Business Investment Company (MESBIC) venture capital programs, provided $2 billion in equity capital to 70,000 small businesses, creating 250,000 jobs.

- SBA, through its 503 Development Company Loan Program, provided $703 million in economic development loans, generating 100,000 jobs.

- Management assistance programs including Small Business Development Centers, Service Corps of Retired Executives (SCORE), Active Corps of Executives (ACE), and Small Business Institutes, have counseled or trained more than 3 million entrepreneurs, teaching them essential management skills, without which many businesses fail.

- The Surety Bond Guarantee Program, enabling small contractors to obtain the surety bonding required to bid on almost all federal, federally-funded, and private construction contracts, has guaranteed 166,000 surety bonds permitting the award of $12.9 billion in contracts.

- Pollution Control Bond Program has provided small firms with an important source of capital as they seek to comply with mandated environmental standards.

- Procurement programs have helped to direct $118.4 billion in federal contracts to small enterprises, $52.3 billion having been achieved through small business "set-asides", and $75.2 billion in subcontracts since 1980.

- SBA's 8(a) program brings minority contractors into the economic mainstream through participation in the federal procurement process. During FY 81 through FY 84, 19,115 Section 8(a) contracts were awarded totalling slightly less than $10 billion.

- The SBA is the only agency in the Executive Branch whose sole mission is to promote and assist our nation's 14 million small concerns. This sector accounts for 97 percent of all new businesses, and annually create over 80 percent of all net, new jobs. Small enterprises have been effectively represented by the SBA Administrator and the Office of Advocacy through many activities including issuance of The State of Small Business: Report of the President, establishment of a small business economic data base, establishment of a toll-free phone line to answer small business questions, sponsorship of state and local legislative issues conferences and planned participation in the White House Conference on Small Business.

- The recently created Small Business Innovation Research (SBIR) Program, which the SBA oversees, resulted in 11 federal agencies making research awards to small research and development companies totalling $416.5 million.

A DESCRIPTION OF EFFECTIVE SBA PROGRAMS MERITING CONTINUANCE

SBA Guaranteed Lending Program: Filling a Critical Credit Gap

The 7(a) Guarantee Lending Program is filling a critical credit gap by providing small enterprises with long-term loans, the toughest to obtain.

GAO's extensive 1983 study of the 7(a) program called it "the Federal Government's answer to small business' need for long-term financing." The study found out that the guarantee program has encouraged lenders to finance new ventures, make longer-term and larger small business loans, with no evidence of "crowding out" of other small business borrowers or discernible impact on the general level of interest rates.

The Guarantee Lending Program has demonstrated its effectiveness by guaranteeing 500,000 loans to small firms, totalling $36 billion.

Small Business Investment Company Program: Public-Private Partnership Provides Equity Capital

The Small Business Investment Act of 1958 which first authorized the Small Business Investment Company (SBIC) Program, recognized "that small business concerns are faced with a real difficulty in obtaining long-term and equity capital required for adequate growth and development. Commercial banks are not able to furnish such financing; their function lies primarily in short- and intermediate-term lending; they do not supply venture capital or long-term credit." This funding void still exists today, and SBA's venture capital programs are filling this critical credit gap.

SBICs and Minority Enterprise Small Business Investment Companies (MESBICs) are SBA licensed companies which, through a private and public sector partnership, provide equity capital, long-term loans, and management assistance to small businesses. SBICs are responsible for many of our nation's great small business success stories. Companies which have stimulated the economy and provided thousands of jobs, such as Apple Computer and Federal Express, would not have started without SBA financing.

In return for a commitment to invest in small businesses, SBICs are licensed by SBA and authorized to issue loans backed by federal guarantees. To be licensed as an SBIC, a company must have at least $500,000 in private sector, paid-in capital. Before an SBIC can leverage any funds, it must have first committed at least 60 percent of its own capital to investments in small business concerns.

SBA, through its SBIC and MESBIC venture capital programs, provided $2 billion in equity capital to approximately 70,000 firms, creating 250,000 jobs. The assisted companies have produced jobs, economic gains, and tax revenues far exceeding the government's outlays, and should be maintained.

503 Certified Development Company Loan Program:
Job Creation and Economic Development at Low Cost to Government

The 503 CDC Loan Program has clearly fulfilled its mandate by spurring economic development and jobs at low cost to the government.

As one of the federal government's primary economic development programs, 503 represents the classic partnership between state and local governments and the private sector in making long-term capital available to healthy small businesses for planned expansion and job creation. Section 503 authorizes the SBA to guarantee debentures issued by Certified Development Companies (CDCs) to finance the acquisition of land, plants, and equipment for small business expansion. With a commitment for a substantial number of new jobs resulting from the expansion before any loan is made, SBA can guarantee up to 40 percent of the project costs, with 50 percent coming from a private sector lender, and 10 percent from the small business itself.

541 CDCs have been certified, funding over 2300 projects, creating or retaining nearly 100,000 jobs. In every quarter since the program's inception, more and more jobs have been created, and the federal commitment per job has declined. This is a federal program that works, and works well.

Management Assistance:
Providing Essential Training, Counseling for Entrepreneurs

The absence of sound management practices is responsible for an estimated 50 percent of all small business failures, and the agency's programs diminish the risks to small business owners by administering preventive medicine in the form of management counseling and training, helping entrepreneurs to hone their management skills and better protect their investments.

SBA's Small Business Development Centers (SBDCs), Service Corps of Retired Executives (SCORE), Active Corps of Executives (ACE), and Small Business Institute (SBI) programs, along with management assistance representatives in each SBA field office, provide a network of affordable management training programs through private sector resources, colleges and universities, state and local governmental agencies.

Since 1979, more than 3 million individuals have received training or counseling through SBA programs. These types of one-to-one counseling and training opportunities, offered at little or no cost by the SBA, are often the only option for the entrepreneur needing answers to serious business problems. It is important that these programs continue.

Surety Bond Guarantee Program:

Small Contractors Bridge to Construction Contracts

Under its Surety Bond Guarantee (SBG) Program, SBA enables small business concerns to obtain the surety bonding required to bid on almost all federal, federally-funded, and private construction contracts. Small firms with limited track records and thin capitalization find it difficult to obtain bonds from commercial bonding companies at reasonable costs. Since the inception of the SBG Program in 1971, 166,132 surety bonds have been guaranteed permitting the award of $12.9 billion in contracts.

After deducting program costs, including losses, SBA can identify approximately $504 million in direct savings (difference between the bid price of the small business participant in the SBG Program and the next low bidder), and has helped thousands of small construction contractors to enter the federal, state or local markets.

Pollution Control Equipment Contract Guarantee Program:

Assistance in Complying With Environmental Regulations

By amendments in 1976 to the Small Business Investment Act of 1958, Congress authorized the Small Business Administration to guarantee 100 percent of the payments due from eligible small businesses under qualified contracts for the planning, design, financing or installation of pollution control facilities or equipment which has been mandated by governmental pollution control regulations. Financing of such contracts may be obtained from theproceeds of tax-exempt bonds issued by state or municipal authorities.

Small business owners, bankers, underwriters, and state pollution control financing agencies have overwhelmingly attested to the importance of small businesses' continued access to this small but crucial source of guarantee authority. It is sound public and fiscal policy to continue to permit small businesses which are forced to install nonproductive pollution control equipment to have access to this important (and often only) source of capital.

Procurement Assistance: Helping Small Business in the $166 Billion Federal Market

The SBA has fulfilled its legislatively mandated mission of assisting small businesses to compete for a federal procurement market that totalled $166 billion, awarded through almost 22 million individual procurement actions. SBA programs both assist small businesses seeking to enter the federal market and result in cost savings to the government.

Under its "set-aside" program, competition for individual agency contracting opportunities may be restricted for exclusive competition by small business concerns. During FY 81-84, the set-aside program awarded $52.3 billion in federal contracts to small businesses, representing approximately 45 percent of the $118.4 billion in total awards to small busines (approximately 21 percent of the $527.4 billion in total procurement expenditures).

Under its Subcontracting Assistance Program, the opportunities for small business concerns to participate in the federal procurement market as subcontractors is encouraged. Public Law 95-507 requires large prime contractors to submit subcontracting plans with specific goals for subcontract participation by small business concerns and disadvantaged small business concerns. During FY 81-84, $75.2 billion in subcontract awards was made to small businesses and $4.7 billion to disadvantaged small business concerns, representing 36.8 percent and 2.3 percent respectively of the $203.9 billion in subcontract awards reported.

The newest and most cost-effective of SBA's procurement assistance programs is the Breakout Procurement Center Representative (BPCR) Program. Begun in FY 80, the goal of the BPCR Program is to create contracting opportunities by "breaking-out" to competition items that have been procured on a sole source basis. During FY 81-82, three pilot BPCRs were stationed at three of the Air Force Logistics Command's five Air Logistics Centers (ALCs). In FY 83, the pilot program was expanded to cover four ALCs. The results for FY 81-83 are dramatic: almost $49 million was saved by the "breakout" of only 2,432 items. Late in FY 84, the program was expanded to cover 10 additional buying centers. The FY 84 results: 14 BPCRs saved almost $152 million through the breakout of only 961 items. On October 30, 1984, the President signed H.R. 4209 establishing the BPCR Program by statute and expanding it to all major DOD buying activities. Given a "spare parts" budget approaching $25 billion and the fact that only 20 percent of the 1.8 million parts screened by DOD are procured competitively, the potential of the BPCR Program is truly outstanding.

In FY 84, procurement programs earned their right to renewal by producing documented savings of more than $400 million to the government.

Disadvantaged Small Business Assistance Programs: Fostering Entry into the Economic Mainstream

SBA uses the federal procurement system to assist small business concerns owned and controlled by socially and economically disadvantaged individuals to enter the economic mainstream. Under the Section 8(a) Program, an executive agency makes a contract with SBA to fulfill a specific agency need for supplies, services or construction; SBA, in turn, then subcontracts with a qualified 8(a) Program participant to fulfill the agency contract. In addition to the contract opportunity, SBA provides direct management and financial assistance to the 8(a) Program participant. During FY 81-84, SBA made 19,115 8(a) program awards, totalling slightly less than $10 billion. In addition, approximately $5.7 billion in contracts were awarded to disadvantaged small business concerns outside the 8(a) Program.

Advocacy: A Vital Agency Function

The agency's role as the advocate and voice of the American small business has been strengthened by the appointment of its Administrator, James C. Sanders, to the Cabinet Council of Commerce and Trade. If the Advocacy functions of the SBA were shifted to the Department of Commerce, the voice of small business would be muffled in a large bureaucracy oriented to big business and international trade.

Every major small business has come out in favor of maintaining the SBA as an independent advocate for small enterprise, including: National Federation of Independent Business, Small Business Legislative Council, Small Business United, Chamber of Commerce, National Association of Small Business Investment Companies, National Small Business Association, Small Business

Service Bureau, Inc., National Association of Women Business Owners, National Association of Minority Contractors, Latin American Manufacturers Association, National Association of Development Comapnies, American Association of Nurserymen, National Society of Public Accountants, International Communications Industries Association, National Association of Plumbing-Heating-Cooling Contractors, Independent Electrical Contractors, Inc.

Small Business Innovation Research Program: Agency Helps Small Firms Obtain Research Awards

The Small Business Innovation Research (SBIR) Program was borne out of Congressional concern that 95 percent of federal research and development funds were being channeled to large businesses, non-profit companies, universities, and government laboratories, while the small business sector received virtually no awards. The SBA is charged with overseeing and monitoring 11 federal agencies and the program's first year achievements were praised by President Reagan in his 1983 State of Small Business Report: "The first year of the Small Business Innovation Research (SBIR) program demonstrated the critical role played by small business research and development companies. The SBIR program resulted in ten federal agencies making over 800 research awards to small firms."

According to President Reagan, SBIR is "creating new opportunities for small business and increasing federal agencies' utilization of small businesses' technological expertise." Since 1982, the SBIR program monitored by SBA has resulted in $416.5 million in grant awards to small research and development firms. The small business sector stands to lose a great deal if SBA oversight were removed from this program.

SBA: A MISSION FULFILLED

- ISSUED DIRECT AND GUARANTEED LOANS TOTALLING ***$36 BILLION*** TO ***500,000*** SMALL BUSINESSES
- PROVIDED ***$2 BILLION*** IN EQUITY CAPITAL TO ***70,000*** FIRMS CREATING ***250,000*** JOBS
- PROVIDED ***$703 MILLION*** IN ECONOMIC DEVELOPMENT LOANS CREATING ***100,000*** JOBS
- PROVIDED MANAGEMENT TRAINING AND COUNSELING TO ***3 MILLION*** ENTREPRENEURS
- ASSISTED SMALL FIRMS IN OBTAINING $118.4 BILLION IN FEDERAL PRIME CONTRACT AWARDS
- ASSISTED SMALL COMPANIES IN OBTAINING ***$75.2 BILLION*** IN SUBCONTRACT AWARDS
- AWARDED ***$10 BILLION*** IN GOVERNMENT CONTRACTS TO MINORITY BUSINESSES
- ISSUED ***900,000*** DISASTER RELIEF LOANS TOTALLING ***$12 BILLION***
- GUARANTEED ***166,000*** SURETY BONDS PERMITTING AWARDS TOTALLING ***$12.9 BILLION*** TO SMALL CONTRACTORS
- SBIR PROGRAM RESULTED IN ***$416.5 MILLION*** IN GOVERNMENT AWARDS TO SMALL RESEARCH FIRMS

PREPARED BY THE STAFF OF THE
SENATE SMALL BUSINESS COMMITTEE

OMB'S CASE FOR ELIMINATING SBA IS RIDDLED WITH MISLEADING OR INACCURATE STATEMENTS

OMB: MOST SMALL BUSINESSES GET ALONG FINE WITHOUT SBA ASSISTANCE OR CREDIT SUBSIDIES.

	TOTAL SMALL BUSINESS
NUMBER OF U.S. SMALL BUSINESSES	14,300,000
NUMBER GETTING SBA CREDIT	21,500
PERCENT OF GETTING SUBSIDIZED CREDIT	0.2%

RESPONSE:

- THE ***14.3 MILLION*** REFERENCE IS WRONG. GAO REPORTS THAT ONLY ***4.5 MILLION*** FIRMS HAD APPLIED FOR CREDIT IN THEIR LIFETIME
- OMB'S ***21,500*** IS MISLEADING. THAT NUMBER REFLECTS ONLY THOSE SBA LOANS, EXCLUDING SBIC'S, DISBURSED IN ONE YEAR. SINCE 1953, SBA HAS FINANCIALLY ASSISTED ***500,000*** SMALL BUSINESSES, PROVIDING ***$36 BILLION*** IN FINANCING, SUSTAINING NEARLY ***5 MILLION*** EMPLOYEES, AT THE TIME THEY APPLIED FOR ASSISTANCE
- GAO DISAGREED WITH THE ADMINISTRATION'S ANALYSIS OF THE IMPACT OF THE SBA LENDING PROGRAMS. GAO STATED:

> *"THAT APPROXIMATELY **30 TO 40 PERCENT** OF THE DOLLAR AMOUNT OF BANKS' LONG-TERM FINANCING (6 OR MORE YEARS) TO SMALL BUSINESSES MAY CARRY AN SBA GUARANTEE...WHILE OUR ESTIMATE IS NOT PRECISE, IT IS A MEASURE OF THE VALUE OF THE SBA GUARANTEE PROGRAM THAT CONTRASTS WITH THE ADMINISTRATION'S STATEMENT THAT LESS THAN 1 PERCENT OF SMALL BUSINESS ARE SERVED BY THE PROGRAM."*

GAO CONCLUDED THAT "THE IMPACT OF THE 7(A) LOAN PROGRAM IS SIGNIFICANT IN TERMS OF SATISFYING LONG TERM CAPITAL NEEDS."

SBA: A VITAL SOURCE OF LONG TERM FINANCING FOR SMALL BUSINESS

GAO, FOLLOWING AN EXTENSIVE STUDY OF SBA'S 7(A) LENDING PROGRAM ASSERTS:*

- SMALL BUSINESSES HAVE FACED EXTREME DIFFICULTIES IN OBTAINING LONG TERM FINANCING FOR THE LAST 50 YEARS
- SBA'S LOAN GUARANTEE PROGRAM HAS FILLED THIS CRITICAL GAP AND HAS BEEN SMALL BUSINESSES' ANSWER TO ITS LONG TERM FINANCING NEEDS (LOANS FOR 6 YEARS AND OVER)
- SBA HAS ENABLED LENDERS TO MAKE INCREASED NUMBERS OF LONG TERM LOANS BY PROVIDING THEIR GUARANTEES

GAO'S STATISTICAL SAMPLING OF APPROXIMATELY 60 PERCENT OF ALL COMMERCIAL BANKS FOUND:

- 13 PERCENT OF ALL OUTSTANDING SMALL BUSINESS LOANS WERE SBA-GUARANTEED
- 74 PERCENT OF SBA GUARANTEE LOANS WERE LONG TERM, WHILE ONLY 15 PERCENT OF NON-GUARANTEE LOANS TO SMALL BUSINESSES WERE LONG TERM
- 82 PERCENT OF LENDERS STATED THAT WITHOUT THE SBA GUARANTEE, THE LOANS THEY ISSUED TO SMALL BUSINESSES WOULD NOT HAVE BEEN MADE, OR WOULD HAVE HAD MORE STRINGENT TERMS AND CONDITIONS

*1983 REPORT TO CONGRESS, "SBA'S 7(A) LOAN GUARANTEE PROGRAM: AN ASSESSMENT OF ITS ROLE IN THE FINANCIAL MARKET"

OMB's PROPOSED SALE OF THE SBA LOAN PORTFOLIO: AN EXERCISE IN FISCAL IRRESPONSIBILITY

BILLIONS WOULD BE LOST BY SELLING SBA's LOAN PORTFOLIO RATHER THAN ALLOWING THE AGENCY TO MANAGE IT

OMB'S PROPOSED SALE

- WOULD SELL SBA's LOAN PORTFOLIO VALUED AT APPROXIMATELY $12 BILLION OVER A 4-YEAR PERIOD
- OMB PROJECTS RECEIPT OF 19 CENTS FOR EACH DOLLAR OF LOANS SOLD
- TOTAL RECEIPTS FROM SALE WILL BE APPROXIMATELY $2.3 BILLION

SBA PORTFOLIO MANAGEMENT

- WOULD SERVICE AND COLLECT PAYMENTS ON THE SBA LOAN PORTFOLIO CONSISTING OF LOANS WITH AN AVERAGE LIFE OF 9 YEARS
- BASED ON SBA's HISTORICAL COLLECTION DATA, WOULD COLLECT 80 CENTS FOR EACH DOLLAR OF LOANS
- THROUGH MANAGEMENT OF PORTFOLIO, WOULD COLLECT APPROXIMATELY $9.6 BILLION

DIFFERENCE BETWEEN OMB's PROPOSED SALE AND SBA's PORTFOLIO MANAGEMENT:

SBA MANAGEMENT — $9.6 BILLION
OMB SALE — $2.3 BILLION
$7.3 BILLION

RESULT: OMB's DESIRE FOR SHORT TERM DEFICIT REDUCTION "SAVINGS" WILL COST THE TAXPAYERS $7.3 BILLION

NOTE: SBA's ADMINISTRATIVE COST FOR MANAGEMENT OF THE PORTFOLIO IS ESTIMATED TO COST AN ADDITIONAL $400 MILLION TO ACHIEVE THE $7.3 BILLION SAVINGS.

OMB'S CASE FOR ELIMINATING SBA IS RIDDLED WITH MISLEADING OR INACCURATE STATEMENTS

OMB: SBA LOAN SUBSIDIES GO MOSTLY TO ECONOMIC STRAP HANGERS – WEAK BUSINESSES WHO GET REPEATED SBA LOANS.

- 53 PERCENT OF 1982 SBA BORROWERS WERE REPEAT CUSTOMERS
- 77 PERCENT OF 1983 (FIRST HALF) SBA BORROWERS WERE REPEAT CUSTOMERS

RESPONSE: **FIRST, OMB'S NUMBERS ARE WRONG. THE FACTS ARE:**

- **14.4 PERCENT OF 1982 SBA BORROWERS WERE REPEAT CUSTOMERS**
- **16.4 PERCENT OF 1983 SBA BORROWERS WERE REPEAT CUSTOMERS**
- **13 PERCENT OF 1984 SBA BORROWERS WERE REPEAT CUSTOMERS**

SECOND, SBA GUARANTEED LOANS DON'T GO TO "ECONOMIC STRAP HANGERS," BUT RATHER TO CREDIT WORTHY ENTREPRENEURS, WHO FIND LONG TERM CAPITAL DIFFICULT, IF NOT IMPOSSIBLE TO OBTAIN. AS AN EXAMPLE, THE FOLLOWING LIST OF COMPANIES HAVE RECEIVED AN SBA GUARANTEED LOAN:

NIKE SHOES (FORMERLY BLUE RIBBON SPORTS), BEAVERTON, OR
WINNEBAGO (FORMERLY MODERNISTIC INDUSTRIES), FOREST CITY, LA
AIR MIDWEST, WICHITA, KS
LIQUID PAPER, GREENVILLE, TX
TORTINO PIZZA (PILLSBURY), MINNEAPOLIS, MN
HEALTHDYNE, INC., MARIETTA, GA
GODFATHER'S PIZZA, OMAHA, NE
M & M PRODUCTS, ATLANTA, GA
COBE LABS, LAKEWOOD, CO
DOLE HAM PACKING, WICHITA, KS

OMB'S CASE FOR ELIMINATING SBA IS RIDDLED WITH MISLEADING OR INACCURATE STATEMENTS

OMB: THE SBA'S $4 BILLION ANNUAL LOAN GUARANTEE PROGRAM IS ECONOMICALLY COUNTER-PRODUCTIVE AND RESULTS IN MASSIVE FEDERAL LOAN DEFAULT COSTS.

- OVER THE LAST DECADE, THE FEDERAL TREASURY HAS BEEN REQUIRED TO PAYOUT $4 BILLION ON DEFAULTED LOANS:

RESPONSE: **FIRST, THE $4 BILLION ANNUAL GUARANTEE PROGRAM LEVEL IS WRONG. THE GUARANTEED LOAN PROGRAM HAS NEVER REACHED $4 BILLION SINCE ITS INCEPTION. FOR FISCAL YEAR 1985, THIS PROGRAM LEVEL IS $3.4 BILLION AND BEFORE THAT WAS NEVER HIGHER THAN $3.1 BILLION.**

SECOND, OMB'S $4 BILLION PAYOUT FIGURE FOR DEFAULTED LOANS MISREPRESENTS THE TRUE COST OF THE LENDING PROGRAMS. IT ONLY TELLS HALF THE STORY. SBA, AFTER PURCHASING A LOAN, SERVICES THE LOAN UNLESS LIQUIDATION PROCEDURES BECOME NECESSARY. AS A RESULT, ADDITIONAL REVENUE IS GENERATED.

	1972-76	1977-80	1981-84	TOTAL
		(IN MILLIONS)		
PAY-OUT ON DEFAULTED LOANS	$805	$1,029	$2,413	$4,247
REVENUES COLLECTED THROUGH SERVICING/LIQUIDATION	$592	$ 600	$1,624	$2,816
LOANS CHARGED OFF	$213	$ 429	$ 789	$1,431

SINCE 1972, OVER $24 BILLION IN LOANS WAS DISBURSED AT A COST TO THE TREASURY OF $1.4 BILLION, NOT $4.2 BILLION—AN ACTUAL LOSS RATE OF 6%.

OMB'S CASE FOR ELIMINATING SBA IS RIDDLED WITH MISLEADING OR INACCURATE STATEMENTS

OMB: IN 1981-82 ONLY ONE-THIRD OF ONE PERCENT OF SBA GUARANTEED LOANS WERE TO COMPUTER, SEMI-CONDUCTOR AND PHARMACEUTICAL MANUFACTURING INDUSTRIES—THE CUTTING EDGE OF U.S. ECONOMIC GROWTH, TECHNOLOGICAL PROGRESS AND JOB CREATION.

RESPONSE: **THIS STATEMENT SHOWS A COMPLETE MISUNDERSTANDING OF THE PURPOSE OF THE SBA GUARANTEED LOAN PROGRAM, WHICH IS DESIGNED TO PROVIDE LONG TERM DEBT FINANCING AND NOT EQUITY FINANCING. CONGRESS HAS NOT TARGETTED PARTICULAR INDUSTRIES FOR BANK GUARANTEED LENDING.**

IT IS THE SBIC PROGRAM THAT WAS SPECIFICALLY DESIGNED TO ASSIST SMALL COMPANIES REQUIRING EQUITY FINANCING. ACCORDING TO SBA STATISTICS, SBIC ACTIVITY DURING THE LAST FOUR YEARS IN THE HI-TECH INDUSTRY AS A PERCENTAGE OF THE TOTAL PROGRAM HAS BEEN:

1981	**39 PERCENT**
1982	**44 PERCENT**
1983	**50 PERCENT**
1984	**52 PERCENT**

YET, UNDER THE OMB PROPOSAL, THE SBIC PROGRAM WHICH REPRESENTS OVER 20 PERCENT OF VENTURE CAPITAL FINANCING, WOULD ALSO BE ELIMINATED.

OMB'S CASE FOR ELIMINATING SBA IS RIDDLED WITH MISLEADING OR INACCURATE STATEMENTS

OMB: THE SURGE OF PRIVATE VENTURE CAPITAL DUE TO TAX REFORMS AND INCENTIVES IS A FAR MORE APPROPRIATE AND EFFECTIVE SOURCE OF SMALL BUSINESS INVESTMENT FUNDS.

VENTURE CAPITAL INVESTED	
1980	$ 4.5 BILLION
1983	$12.1 BILLION

RESPONSE: **OMB STATEMENT IS MISLEADING. IT SUGGESTS THAT THERE IS A VENTURE CAPITAL POOL OF $12 BILLION THAT SMALL FIRMS CAN EFFECTIVELY TAP. THE FACTS SPEAK OTHERWISE:**

- **ACCORDING TO VENTURE CAPITAL JOURNAL ONLY $2.8 BILLION WAS ACTUALLY INVESTED IN 1983**
- **THE MEMBERS OF THE NATIONAL VENTURE CAPITAL ASSOCIATION, REPRESENTING 71 PERCENT OF THE TOTAL VENTURE CAPITAL INVESTMENTS, FINANCED ONLY 973 BUSINESSES IN 1983**
- **THE ADMINISTRATION PROPOSES CUTTING OVER 20 PERCENT OF THE AVAILABLE VENTURE CAPITAL DOLLARS BY CALLING FOR THE ELIMINATION OF THE SBIC PROGRAM**
- **EQUITY FINANCING IS NOT A SUBSTITUTE FOR DEBT FINANCING**

SBIC PROGRAM: A PUBLIC-PRIVATE PARTNERSHIP THAT WORKS

SINCE THEIR INCEPTION IN 1958, SBIC'S HAVE PROVIDED $5.0 BILLION IN VENTURE CAPITAL TO APPROXIMATELY 70,000 FIRMS. MANY OF THESE SMALL FIRMS HAVE EXPERIENCED REMARKABLE ECONOMIC GROWTH, GENERATING NEW JOBS AND REVENUES. IN THE LAST TEN YEARS, SBA ESTIMATES OVER 250,000 NEW JOBS HAVE BEEN CREATED BY SMALL FIRMS RECEIVING SBIC FINANCING.

Examples of Small Companies That Received Financing from the SBIC Program:

	AT TIME OF SBIC FINANCING				AS OF LAST AVAILABLE DATA				
	AS OF	SALES	PROFITS	EMPLOYEES	AS OF	SALES	PROFITS	TAXES	EMPLOYEES
APPLE COMPUTER, INC.	9/30/77	$ 773,977	$ 41,575	63	9/30/83	$ 982,769,000	$ 76,714,000	$ 69,408,000	2050
FEDERAL EXPRESS CORP.	6/30/73	6,769,112	(4,460,896)	518	5/31/84	1,436,305,000	115,430,000	(15,964,000)	18400
INTEL CORPORATION	12/31/69	565,874	(1,887,808)	218	12/31/83	1,121,943,000	116,111,000	62,344,000	19400
ROLM CORPORATION	7/ 3/70	292,253	(358,586)	32	7/01/83	502,642,000	60,952,000	25,409,000	7049
CRAY RESEARCH, INC.	12/31/72	58,327	(3,137)	12	12/31/83	125,008,000	26,071,000	19,991,000	1551
PANDICK, INC.	5/31/65	3,315,665	55,497	655	8/31/83.	121,086,000	10,038,000	9,653,000	1300
LIFELINE SYSTEMS, INC.	12/31/79	707,000	(260,000)	19	12/31/83	9,644,000	348,000	12,000	220
DIGITAL SWITCH CORP.	6/30/79	0	(639,532)	20	12/31/83	127,052,000	25,473,000	19,737,000	894
NBI, INC.	6/30/76	451,186	(859,809)	55	6/30/83	96,780,000	4,590,000	1,095,000	1846
NETWORK SYSTEMS CORP.	12/31/75	25,690	(348,099)	12	12/31/83	47,030,000	10,030,000	7,275,000	462
RECORDED TOTALS		$12,959,084	($8,720,795)	1604		$4,570,259,000	$445,757,000	$198,960,000	53172

ABOLISH THE SMALL BUSINESS ADMINISTRATION

	1986	1987	1988	1986–88	1989	1990
CURRENT SERVICES						
Budget Authority	$1,472	$1,555	$1,628	$4,655	$1,691	$1,746
Outlays	1,325	1,423	1,509	4,257	1,589	1,646
SAVINGS						
Budget Authority	−1,190	−1,779	−1,961	−4,930	−2,023	1,625
Outlays	−1,467	−1,904	−1,930	−5,301	−1,863	−1,475
1986 BUDGET LEVEL						
Budget Authority	282	−224	−333	−275	−331	121
Outlays	−142	−482	−421	−1,045	−274	171

NOTE: Dollars in millions.

PROPOSAL

- Terminate SBA credit programs, including direct and guaranteed business and disaster loans.

- Transfer existing portfolio to Treasury for liquidation over a four-year period.

- Retain significant small business "voice" by creating a new Administration for Enterprise Development and Opportunity in the Department of Commerce.

- Transfer to the new Administration many non-credit SBA activities, including advocacy, minority small business, procurement, innovation, research and technology, and service corps of retired executives.

RATIONALE

Replacing SBA's heavy lending emphasis with a focus on advocacy and special programs will redirect Federal resources away from special advantages for a relative handful of "government-wise" loan seekers.

Most small businesses get along fine without SBA assistance or credit subsidies.

Total Small Business	
Number of U.S. small businesses	14,300,000
Number getting SBA credit	21,500
Percent getting subsidized credit	0.2%
1983 New Small Business	
U.S. total	600,000
SBA aided	less than 2%

The surge of private venture capital due to tax reforms and incentives is a far more appropriate and effective source of small business investment funds.

VENTURE CAPITAL INVESTED	
1980	$4.5 billion
1983	$12.1 billion

Most SBA credit goes to mainstream small business and service establishments where the private marketplace generates ample investment, competition and consumer supply without subsidized government credit.

- In 1982 restaurants and bars were the largest SBA loan guarantee recipient category ($153 million or seven percent of total loans);

- In 1981 auto dealers and related retail and service firms were the largest loan guarantee recipient category ($346 million or 11.1 percent of total);

- Physicians, dentists and veterinarians obtained $143 million in loan guarantees in 1981–82 (all are generally a good credit risk and should not require SBA assistance);

- In 1981–82 only one-third of one percent of SBA guaranteed loans went to computer, semi-conductor and pharmaceutical manufacturing industries—the cutting edge of U.S. economic growth, technological progress and job creation.

SBA loan subsidies go mostly to economic strap hangers—weak businesses who get repeated SBA loans.

- 53 percent of 1982 SBA borrowers were repeat customers;

- 77 percent of 1983 (first half) SBA borrowers were repeat customers.

SBA requires nearly one-quarter of a billion dollars per year to fund its bureaucracy and local office network:

- 119 regional, district and branch offices;

- 4,900 employees;

- $221 million in 1984 salaries and expenses.

SBA "lending" programs have a heavy budget impact due to high defaults, subsidized interest, bureaucratic overhead (4,900 employees) and direct Treasury financing of many SBA loan programs. SBA contributed $7.9 billion to the Federal deficit over the last six years and is expected to add another $7.9 billion over the next six years under current services.

The SBA's $4 billion annual loan guarantee program is economically counter-productive and results in massive Federal loan default costs.

- Guarantees go to firms too uncredit-worthy to get regular bank loans or venture capital. This reduces the credit supply to stronger firms and creates subsidized competition for 99 percent of small businesses which pay their own way in the marketplace.

- Default rates are exceedingly high. On guarantees made in the recent past, default rates to date are:

Year	Guarantee Amount	Default Rate
1979	$2.3 billion	19%
1980	$2.4 billion	23%
1981	$2.5 billion	19%

- Over the last decade, the Federal Treasury has been required to payout $4 billion on defaulted loans:

	1972–76	1977–80	1981–84	Total
Pay-out on Defaulted Loans	$805	$1,029	$2,413	$4,247

NOTE: Dollars in millions.

A substantial and effective small business presence within government will be ensured by the proposed Administration for Enterprise Development and Opportunity to be established in the Department of Commerce.

- The advocacy office will speak for the interests of small business within the Executive Branch.
- Efforts will be increased to identify and remove regulatory and legislative impediments to the creation of capital for small business.
- Minority small businesses will continue to receive contractual, financial, and managerial assistance to make them competitive.
- Volunteer retired and active executives will continue to provide management assistance for small business managers and owners.
- Small businesses will continue to be assured a fair share of government procurement, sales, and innovation research.

S. 408, A BILL TO AUTHORIZE AND PROVIDE PROGRAM LEVELS FOR THE SMALL BUSINESS ADMINISTRATION FOR FISCAL YEARS 1986, 1987 AND 1988

THURSDAY, MARCH 7, 1985

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to recess, at 9:40 a.m., in room SR 428A, Hon. Lowell Weicker, Jr. (chairman of the committee) presiding.

Present: Senators Weicker, Kasten, Bumpers, Dixon, and Kerry.

Staff present: Robert J. Dotchin, staff director; R. Micheal Haynes, chief counsel; John W. Ball III, minority chief counsel; and Dorothy C. Olson, hearing clerk.

The CHAIRMAN. The committee will come to order.

This will be the third day of hearings on S. 408, a bill to authorize and provide program levels for the Small Business Administration for fiscal years 1986, 1987, and 1988.

I have no opening statement. Senator Dixon, do you have an opening statement?

Senator DIXON. I do not, Mr. Chairman. At the appropriate time, I want to have the honor and the pleasure of introducing the distinguished mayor of Springfield, IL.

The CHAIRMAN. All right. Then we will start off with the lead witness, who is Hon. Marlene Johnson, Lieutenant Governor of the State of Minnesota.

It is very nice to have you here.

STATEMENT OF HON. MARLENE JOHNSON, LIEUTENANT GOVERNOR, STATE OF MINNESOTA

Governor JOHNSON. Thank you, Senator.

Mr. Chairman and members of the committee, I am honored that you have asked me to appear today to present my views on the Small Business Administration. I am also very pleased to give my full support to S. 408, Senator Weicker's bill funding the SBA for fiscal years 1986 to 1988.

During the past 15 years, I have had the opportunity to work with the SBA through a number of different avenues. My first contact was in the early 1970's as a new business owner in St. Paul. As a person with no prior business experience, I naturally turned to the SBA for valuable startup advice.

As the business grew, I returned to the SBA—as did hundreds of other Minnesota entrepreneurs—for a loan guarantee to aid in that expansion.

As cochair of the Minnesota delegation to the 1980 White House Conference on Small Business, and in my capacity as president of the National Association of Women Business Owners, I had the privilege to participate in the discussions that ultimately resulted in the SBA's women's business enterprise program.

That was a major breakthrough and provided a whole new set of opportunities for women entrepreneurs, resulting in thousands of new, job-creating enterprises throughout the country.

Finally, as Lieutenant Governor, I have had the opportunity to work with the SBA from a different perspective, that of partner. Working hand in hand with our district office, the State of Minnesota has participated in a number of joint programs to assist small and emerging enterprises.

Together we have created a partnership that reflects the SBA's capacity and willingness to respond to the rapidly changing opportunities for nurturing small businesses in our community.

Why is the SBA so important? A Cabinet-level agency directed at small businesses is a clear message that the Federal Government is serious, that it recognizes that small businesses are the heart and soul of the free enterprise system.

Small businesses create the jobs that fuel economic growth. Most of the 20 million jobs created in the 1970's were by small businesses. This trend continued through 1983, despite the recession, when newer businesses added at least 750,000 new jobs. During those same 3 years, Fortune 500 companies lost some 3 million jobs.

And small business is the source of technological innovation, providing 24 times as many industrial innovations per research dollar as do large companies.

The SBA is not a static bureaucracy. With a dynamic, constantly changing constituency, they are forced to change as well. For example, when the Agency determined that loan guarantee processing was an unnecessary burden, they transferred that responsibility to financial institutions through their Bank Certification Program.

As it has become increasingly clear that America's best hope for ongoing job creation lies in our ability to stimulate new business starts, technological innovation, and small business growth, the SBA is in a key position to continually assess the needs of growing businesses. It is often the agent bringing together communities and businesses to address those needs.

Whether that means providing financing, counseling, procurement, or management assistance is not important. What is important is that the Agency contributes to the solid foundation of public/private commitment to the success of our Nation's emerging businesses.

That is why I find it so ironic that the administration has proposed the abolition of the SBA. How can the administration that preaches "trickle-down" job creation eliminate the agency that serves the sector of the economy where the vast majority of the poor and minorities are employed?

How can the administration whose goal is to eliminate waste and inefficiency support tax policies that encourage hostile corporate takeovers and, at the same time, eliminate services for the most efficient sector of our economy?

How can the administration support unprecedented increases in a bloated defense budget and then turn around and cite duplication and unnecessary services in an agency whose annual budget is less than one-tenth the price of one Trident submarine?

Let me make this clear: What we are talking about is not a welfare handout or a special favor to the wealthy. We are talking about a very modest commitment to the free enterprise system. This bill freezes SBA spending at the 1985 levels and eliminates most of the Agency's Direct Loan Programs.

It is appropriate that the SBA share in our national commitment to balance the budget. And I believe that entrepreneurial creativity within the Agency will identify new ways to provide services within the limits of the 1985 levels. But that is a far cry from the elimination of the agency and all of its credit programs.

If that were to happen, not only would it eliminate financing that in many, many cases has paid for itself several times over, but it would send a message to the millions of existing and potential entrepreneurs out there that the Federal Government will no longer share in the responsibility of creating a supportive environment for them.

It would say that the Government is willing to create costly regulations and complicated tax policies for smaller and newer enterprises but is unwilling to provide an advocate to help cope with those problems.

It would say that the Government won't back its rhetoric with action. But, most of all, it smacks of hypocrisy.

I know it has been said that many businesses have been successful without the help of the SBA. That is true. But it is hardly a way to measure the cost effectiveness of an agency.

Instead, I would present you with some statistics that tell a different story: 6,200 jobs were created or retained in Minnesota alone because of financial assistance provided by the SBA this past fiscal year; 271 loans were guaranteed; and 4,900 individuals received SBA counseling in Minnesota during that same period.

All this leads to our stories of success, such as Rose Totino, who used a $50,000 loan from the SBA in 1962 to turn her local restaurant into Totino's Pizza, one of the world's most successful frozen pizza businesses.

Or Bill Benzick, who is with me today. Bill owns Best, Inc., an institutional food service business. He has, over 10 years, built his company from scratch to a business currently employing nearly 300. He has benefited from procurement counseling, management assistance, and was also the recipient of a guaranteed loan.

The Riser Electric Co. of St. Paul, with me today as well, is yet another example.

To me, that is the best way to evaluate what the SBA has meant to Minnesota as well as the rest of the country. The SBA mission is to serve the small business community. It has responded to what the small business community wants and needs.

America's small businesses deserve better than the elimination of the SBA. Thank you.

[The prepared statement of Governor Johnson follows:]

PREPARED TESTIMONY OF
LIEUTENANT GOVERNOR MARLENE JOHNSON
STATE OF MINNESOTA

U.S. SENATE COMMITTEE ON SMALL BUSINESS
HEARING ON S.408
MARCH 7, 1985

Mr. Chairman and members of the committee, I'm honored that you have asked me here today to present my views on the Small Business Administration. I'm also very pleased to give my full support to S.408, Senator Weicker's bill funding the SBA for Fiscal Years 1986-1988.

During the past fifteen years, I've had the opportunity to work with the SBA through a number of different avenues. My first contact was in the early 1970s as a new business owner in St. Paul. As a person with no prior business experience, I naturally turned to the SBA for valuable start-up advice.

And as the business grew, I returned to the SBA -- as did hundreds of other Minnesota entrepreneurs -- for a loan guarantee to aid in that expansion.

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-- This trend continued through 1983, despite the recession, when newer businesses added at least 750,000 new jobs. (During those same three years, Fortune "500" companies lost some three million jobs.)

-- And small business is the source of technological innovation -- providing twenty-four times as many industrial innovations per research dollar as do large companies.

The SBA is not a static bureaucracy. With a dynamic, constantly changing constituency, they are forced to change as well. For example, when the agency determined that loan guarantee processing was an inappropriate burden, they transferred that responsibility to financial institutions through their bank certification program.

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Whether that means providing financing, or counseling, or procurement or management assistance is not important. What is important is that the agency contributes to the solid foundation of public/private commitment to the success of our Nation's emerging businesses.

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Let me make this clear: what we are talking about is not a welfare handout, or a special favor to the wealthy. We are talking about a very modest commitment to the free enterprise system. This bill freezes SBA spending at 1985 levels and eliminates most of the agency's direct loan programs.

It is appropriate that the SBA share in our national commitment to balance the budget. And I believe that entrepreneurial creativity within the agency will identify new ways to provide services within the limits of the 1985 levels.

But that is a far cry from the elimination of the agency and all of its credit programs.

If that were to happen, not only would it eliminate financing that in many, many cases has paid for itself several times over, but it would send a message to the millions of existing and potential entrepreneurs out there that the federal government will no longer share in the responsibility of creating a supportive environment for them.

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-- 6200 jobs were created or retained in Minnesota because of financial assistance provided by the SBA this past fiscal year;

-- 271 loans were guaranteed; and

-- 4900 individuals received SBA counseling in Minnesota during that same period.

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America's small businesses deserve better than the elimination of the SBA.

Thank you.

COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGICAL INNOVATION

Committee Resolution
Federal Economic and Community Development Programs

The National Governors' Association's (NGA's) policy position on Economic Development Challenges of the 1980's, Intergovernmental Cooperation in Economic Development (E.-3) reads in part:

> The continued use of many major federal economic development tools is now threatened by reductions in federal funds. The federal role in economic development should be to create a better climate for increased private investments and to provide the more comprehensive resources of the federal government to areas experiencing significant economic problems.

The administration's fiscal year 1986 budget calls for the elimination of the Urban Development Action Grant (UDAG) program, the Business and Industrial (B&I) program, the Small Business Administration (SBA) and the Economic Development Administration (EDA). The proposed fiscal year 1986 budget also calls for a large reduction in funding for the Community Development Block Grant (CDBG) program.

The submitted budget would eliminate the Rental Housing Development (HODAG) program and place a moratorium on major federal housing programs.

The federal role in state and local development initiatives is vital and still needed. programs such as UDAG, EDA and CDBG have provided the financial incentives to spur job creation and capital expansion in distressed communities which have escaped the benefits of economic recovery. Thousands of jobs will not be created and millions of dollars in private investment will be lost, if these programs are terminated or reduced.

The members of NGA's Committee on Economic Development and Technological Innovation firmly support the continued funding of these targetted economic development programs. These important programs have already suffered major reductions over the last four years. The NGA supports an overall freeze in non-defense domestic discretionary spending as a contribution to the reduction of the high national deficit. NGA can not condone, however, additional program cuts or eliminations since they are neither warranted nor cost effective.

Impact of U.S. Small Business Administration Programs in Minnesota

A Report to the Commissioner of Energy and Economic Development

January 1985

JAN 21 22

Prepared by
Program of Business Information
Minnesota Department of Energy and
Economic Development
900 American Center
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St. Paul, Minnesota 55101
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INTRODUCTION AND METHODOLOGY

This report, prepared in cooperation with the Minneapolis district office of the U.S. Small Business Administration (SBA), examines the impact of SBA activities in Minnesota for fiscal years 1984 and 1983.

Data were obtained from several sources within the Minneapolis SBA office including:

- ° Interviews with district office staff
- ° Reports published by SBA
- ° Data obtained from SBA's Chicago regional office
- ° Data compiled from Minneapolis district office files.

In addition, information was obtained from applicable federal regulations. Specific sources of information contained in this report are itemized below.

Special thanks are due to Celso C. Moreno, district director of the Minneapolis SBA office, and his staff, whose cooperation and generous assistance made this report possible.

Sources of Data

Financing Programs

Loan and portfolio activity: SBA Management Information Summary Region V (September, 1984; September, 1983).

Jobs retained and created: Minneapolis SBA files.

Descriptive Narrative: Report of District Director to Minnesota SBA District Advisory Council (June 24, 1984) (SBA files); 13 Code of Federal Regulations (Jan. 1, 1983); interviews with Minneapolis SBA staff.

Procurement and Contract Assistance

PASS Registration, Certificates of Competency, Surety Bond Guarantees: Minneapolis SBA files, on inquiry to Chicago Regional Office.

SBIR Awards, Conference Data: Minneapolis SBA office, on inquiry to Minnesota Project Innovation.

Descriptive Narrative and Estimates: Interviews with Minneapolis SBA staff; SBA publications; **13 Code of Federal Regulations** (Jan. 1, 1983).

SBIC and MESBIC Licensees: Minneapolis SBA files.

Minority Small Business and Capital Ownership Development

Section 8(a) and Section 7(j) awards and projections: Interviews with Minneapolis SBA staff.

Business Development Expense: Minneapolis SBA office, on inquiry to Chicago Regional Office.

Loans to Minority owned firms and economic opportunity loans: SBA Management Information Summary - Region V (September, 1984; September, 1983).

Descriptive Narrative: Interviews with Minneapolis SBA staff; SBA publications.

Management Assistance; Advocacy

All material: Minneapolis SBA files; interviews with Minneapolis SBA staff.

Service

Volume of Activity: Compiled from data maintained by Minneapolis SBA staff.

Loan Servicing Liquidation: **SBA Management Information Summary Region V** (September, 1984; September, 1983).

SUMMARY OF SELECTED SBA ACTIVITIES IN MINNESOTA
(Fiscal 1984)

FINANCING PROGRAMS:

Business Loans	Number	SBA Participation
7(a) Direct Loans	24	$ 1.9 million
7(a) Immediate Participation Loans	6	.6 million
7(a) Guaranteed Loans	271	46.1 million
503 Development Company Loans	40	5.9 million
Economic Opportunity Loans	2	.06 million
Disaster Loans	34	1.4 million
Jobs Retained or Saved	6200	
SBIC Licensees (includes 1 MESBIC)	15	

PROCUREMENT AND CONTRACT ASSISTANCE

Federal contract dollars awarded to small businesses		$ 154.7 million
Section 8(a) subcontract dollars awarded		5 million
Certificates of competency issued	6	.7 million
Surety bond guarantees	469	28.8 million
Business development expense awarded		.08 million
Small businesses registered in PASS	2400	
Procurement conferences held	9	
Attendees at procurement conferences	5000	

SMALL BUSINESS INNOVATION RESEARCH

Phase I contracts awarded	10	.4 million
Phase II contracts awarded	4	1 million

MANAGEMENT ASSISTANCE

Number of individuals counseled	4900	
Management training programs held	265	
Attendees at management training programs	11,400	
Loan information seminars held	250	
Attendees at loan information seminars	1200	

OTHER ACTIVITIES

Loan applications received	640	
Inquiries responded to by mail	6800	
Business loans serviced	550	35.2 million
Disaster loans serviced	1700	26.5 million

SBA FINANCING PROGRAMS

In fiscal 1984 (October 1, 1983 - September 30, 1984), financing programs of the U.S. Small Business Administration provided 378 business and disaster loans totalling approximately $56 million to Minnesota firms or individuals. Over 6200 new or retained jobs are attributable to this assistance.

In fiscal 1983, SBA made or guaranteed 335 business and disaster loans, totalling approximately $44 million, to Minnesota businesses and individuals. These loans resulted in the creation or retention of over 4500 jobs.

The total loan portfolio managed by SBA in Minnesota as of the end of fiscal 1984 consisted of approximately 4500 loans, totalling nearly $259 million. At the end of fiscal 1983, there were approximately 4900 loans, totalling approximately $259.5 million.

SBA financing programs include:

- 7(a) business loan program
- 503 loan program
- Economic opportunity loans
- Handicapped assistance loans
- 501 and 502 loan programs
- Disaster loans
- Energy loan program

7(a) Business Loans

7(a) business loans may be made to qualified manufacturers, wholesalers, retailers, service establishments and other firms when financing is not otherwise available on reasonable terms.

7(a) assistance may be used to finance business construction, conversion or expansion; to finance the purchase of equipment, facilities, machinery, supplies or materials; or to supply working capital.

7(a) loans may be made on a direct, immediate participation or guaranteed basis.

- **Direct loans** are made by SBA to a qualified borrower when no participation or guaranteed loan is available. Maximum SBA exposure is generally $150,000, but the maximum may be extended to $350,000 if authorized by the regional administrator.

In fiscal 1984, SBA in Minnesota made 24 direct 7(a) loans. The SBA share was $1,893,000.

In fiscal 1983, SBA made 16 direct 7(a) loans to Minnesota firms. The SBA share was $1,156,000.

° **Immediate participation loans** are those where either SBA or a financial institution agrees to purchase from the other, immediately upon disbursement, an agreed percentage of each disbursement. Maximum SBA participation is 75 percent of the amount of the loan. An immediate participation loan may not be made if a guaranteed loan is available.

In fiscal 1984, SBA in Minnesota participated on an immediate basis in six 7(a) loans. The SBA share was $587,000; the project total was $874,000.

In fiscal 1983, there were two immediate participation loans made in Minnesota, for which the SBA share was $438,000. Total project cost was $525,000.

° **Guaranteed loans** are loans made by a lender to qualified small business concerns under a Guaranty Agreement between SBA and the lender. Under the Guaranty Agreement, SBA is obligated to purchase up to 90 percent of the outstanding balance of the loan, together with accrued interest, upon default by the borrower. Maximum SBA exposure is $500,000.

In fiscal 1984, SBA in Minnesota guaranteed 271 7(a) loans, for which SBA participation was $46,097,000. Total project cost was $53,345,000.

In fiscal 1983, 288 guaranteed loans were made in Minnesota. SBA participation was $39,602,000; total project cost was $48,346,000.

Within the 7(a) category in fiscal 1984, two direct loans and 11 guaranteed loans were made to Minnesota firms owned by minorities. These loans amounted to $150,000 and $1,550,000, respectively. In fiscal 1983, four direct loans and seven guaranteed loans were made to minority firms in Minnesota. SBA participation in these loans was $211,000 and $648,000, respectively.

(Note: Data on loans to businesses owned by women, Vietnam-era and disabled veterans, and handicapped persons are available by special request. Similarly, loans in the SBA portfolio may be broken out by county. These data require a special computer run, and can be available within approximately three weeks of request.)

Other 7(a) programs include certain short term loan programs (contract loans, seasonal line of credit, and small general contractors); the export revolving line of credit, and loans to qualified employee trusts. These are guarantee programs, which are handled through the borrower's financial institution.

- **Contract loans** may be made to businesses which have been in operation at least 12 months prior to the date of application. Loan proceeds may be used to obtain labor and material necessary to perform an assignable contract. Maximum loan maturity is one year, and assignment of the contract as collateral is required.

- **Seasonal line of credit** loans are secured by inventory and accounts receivable of a seasonal enterprise. The business must have been in operation at least 12 months. The loan term may be up to one year, and must be followed by an "out of debt" period of at least 30 days.

- **Small general contractors** may obtain loans for construction or substantial rehabilitation of residential or commercial property for immediate resale. Loans are for actual expenses only, and the borrower must produce evidence there is a market for the facilities and that mortgage money is available. Maturity is up to 36 months plus the time needed to construct the project.

- **Export revolving line of credit** loans may be used by small businesses to finance labor and material to penetrate foreign markets. The business must be in business at least one full year prior to application. Loan maturity is 18 months. An applicant may be eligible for up to $500,000 in SBA guaranteed funding, plus up to $500,000 from the export-import bank.

- **Qualified employee trusts** may be eligible for a 7(a) guaranteed loan to assist the small business employer who is seeking to finance corporate growth. Loan proceeds must be used to purchase employer securities; the employer must agree to use the loan proceeds solely for the business purpose for which the loan was guaranteed, and the employer must agree to provide the funds for the trust to repay the loan and to make its property available as security. The employer also must give the employees a 90-day "right of first refusal" before relocating or selling the business.

503 Loan Program

Under the 503 loan program, the SBA guarantees the debentures of a certified 503 development company which are issued for the purpose of assisting identifiable small businesses to finance plant acquisition, construction, conversion or expansion. Acquisition of land, and the acquisition and installation of machinery and equipment also are permitted. 503 funds cannot be used for working capital.

A 503 company must be certified by the SBA as capable of providing loan packaging, loan service and business management services The Board of Directors must be representative of government, lenders, and community and business organizations.

One half of the project's funding must be provided from non-federal sources, and typically is obtained through a direct bank loan secured by a first mortgage. The 503 company, the small business concern or some other source provides 10 percent of the funds. The remaining 40 percent is obtained from debentures issued by the 503 company, which are sold to the federal financing bank with 100 percent guarantee by the SBA.

> **In fiscal 1984, 40 loans were made through 503 development companies in Minnesota. The SBA guaranteed debentures totalled $5,862,000.**
>
> **In fiscal 1983, 27 503 loans were made in Minnesota, totalling $2,737,000 (SBA guaranteed portion).**

There are ten 503 development companies certified by the SBA in Minnesota. They are:

- **Opportunities Minnesota, Inc.** (St. Paul) (State of Minnesota 503 Company)
- **Arrowhead Regional Development Corp.** (Duluth)
- **Coon Rapids Development Company** (Coon Rapids)
- **Duluth Business Assistance Corp.** (Duluth)
- **Eastern Minnesota Economic Corp.** (Mora)
- **Faribault Industrial Corporation** (Faribault)
- **Minneapolis 503 Economic Development Co.** (Minneapolis)
- **Prairieland Economic Development Corp.** (Slayton)
- **Region Nine Development Corp.** (Mankato)
- **St. Paul 503 Development Company** (St. Paul)

Economic Opportunity Loans

Economic opportunity loans are directed to small business concerns located in areas with high proportions of unemployment or low income individuals, and small businesses owned by or to be established by persons with low incomes. Management assistance also is available through this program.

In fiscal 1984, SBA made two economic opportunity loans in Minnesota totalling $57,000.

No economic opportunity loans were made in Minnesota in fiscal 1983.

At the end of fiscal 1984 Minneapolis SBA had 79 economic opportunity loans, totalling $2,378,000 in its portfolio. At the end of fiscal 1983, there were 96 such loans, totalling $2,802,000 in the Minneapolis SBA portfolio.

Handicapped Assistance Loans (HAL-1 and HAL-2)

HAL-1 loans are available to public or private non-profit sheltered workshops or similar organizations which employ handicapped individuals for not less than 75 percent of the work hours required, to enable them to produce and provide marketable goods and services. HAL-2 loans are available to acquire, establish or operate a small business concern owned 100 percent by a handicapped person or persons.

The interest rate on the SBA share of a HAL loan is three precent. Loans may be direct (maximum SBA share $350,000) or guaranteed (maximum SBA share $500,000). Maximum maturity is 25 years. Persons who are eligible for 7(a) or economic opportunity loans are not eligible for HAL.

Determination of the number and amount of HAL loans made in Minnesota in fiscal 1984 and fiscal 1983 requires a special computer run (3 weeks' lead time required).

501 and 502 Loan Programs

501 and 502 loans guarantee debentures of state and local development companies, respectively, for loans to small businesses to finance operations, growth, expansion or modernization.

No 501 and 502 loans were guaranteed by SBA in fiscal 1984 or fiscal 1983. According to SBA officials, use of these programs diminished in favor of the 503 loan program.

Disaster Loans

Disaster loans in Minnesota are made or guaranteed by the SBA's Atlanta office. They are then serviced by the SBA office in Minneapolis.

In fiscal 1984, 34 disaster loans, totalling $1,431,000, were made or guaranteed in Minnesota. SBA records show only one disaster loan was made in fiscal 1983, in the amount of $39,000.

The SBA portfolio of disaster loans made or guaranteed in Minnesota and serviced by the Minneapolis SBA office contained 1746 loans totalling $32,714,000 at the end of fiscal 1984. At the end of fiscal 1983, there were 2033 disaster loans in the portfolio, totalling $35,573,000.

Disaster loans may be made when the President, the SBA Administrator or in some cases the Secretary of Agriculture declares a disaster. Generally, there must be a physical catastrophe such as a tornado, flood, drought or similar emergency in which at least 25 homes or businesses in the disaster area sustain uninsured losses of at least 40 percent of their fair replacement value. Disaster assistance may be in the form of physical disaster loans or economic injury loans.

- **Physical disaster** loans are made to individuals and businesses to repair or replace residences or business facilities damaged by the disaster. Individuals may qualify for up to $50,000 to repair or replace damage to land or buildings and up to $10,000 to repair or replace household goods (total cannot exceed $55,000). Businesses are eligible for up to $500,000 or 60 percent of the actual physical loss, whichever is less.

- **Economic injury** loans are made to businesses which can prove they sustained substantial economic injury as a consequence of physical disaster, but which may not have sustained actual physical damage. Funds may be used for such purposes as keeping loan payments current and meeting other current expenses (rent, utilities, etc.)

- **Other economic injury assistance** authorized but generally not funded in the past two fiscal years includes:

  - **Product disaster loans** to small firms that have incurred substantial economic injury because of disease or toxicity resulting from either natural or undetermined causes.

  - **Economic dislocation assistance** for businesses which experience economic dislocation due to an unforseen extraordinary, severe, or temporary natural or other temporary specific condition.

  - **Regulatory economic assistance** for small businesses seeking to comply with federal, state or local laws where compliance without SBA assistance would create substantial economic injury. Examples include compliance with the Coal Mine Health and Safety Act, the Occupational Safety and Health Act and the Clean Air Act.

- **Other economic injury loans** include Strategic Arms Economic Injury loans, Base Closing loans, Emergency Energy Shortage loans, and Water Pollution Control loans.

The SBA's portfolio of loans in Minnesota at the end of fiscal 1984 included 1536 physical disaster loans and 210 economic injury loans. These loans totalled $12,896,000 and $19,819,000, respectively. At the end of fiscal 1983, the portfolio contained 1822 physical disaster loans ($15,015,000) and 211 economic injury loans ($20,558,000).

Energy Loan Program

The SBA energy loan program enables small businesses to enter, continue or expand in the fields of manufacture, sales, installation, service, and development of specific energy conservation measures. Examples of energy conservation measures eligible for assistance under this program include: solar thermal energy equipment; photovoltaic cells and related equipment; certain energy conservation products and services; biomass conversion; industrial cogeneration equipment; hydroelectric power equipment; wind energy conversion equipment, and engineering, architectural and other professional services necessary to aid citizens in utilizing the foregoing measures.

No energy loans have been made in Minnesota under this program in the past several years.

PROCUREMENT AND CONTRACT ASSISTANCE; SMALL BUSINESS INNOVATION RESEARCH

SBA assists small business concerns in obtaining a fair share of government contracts and subcontracts. This assistance is provided through several programs:

- Prime Contract Assistance
- Subcontract Assistance
- Procurement Automated Source System (PASS)
- Certification of Competency
- Surety Bond Guarantee Program
- Small Business Innovation Research (SBIR)

Primary responsibility for administering SBA procurement and contract assistance is assigned to SBA's regional office in Chicago. SBA staff in the Minneapolis district office work with small businesses located in Minnesota to inform them of federal procurement programs and to help them qualify for this assistance. In addition, the Minneapolis SBA office cosponsors several procurement and SBIR conferences annually to further explain these programs.

Prime Contract Assistance

SBA's Prime Contract Assistance program is designed to increase the dollar amount and percentage of awards to small businesses. This is accomplished principally through Procurement Center Representatives (PCRs) stationed at selected military and civilian installations which have major buying programs. (There are no such installations in Minnesota.)

PCRs screen federal procurement requirements valued at more than $2500 (which are not already targeted for small business set aside) to determine whether all or a portion of the procurement can be set aside for small business. Even if specific set aside criteria cannot be met, SBA works with competent small businesses to promote small business participation in the acquisition.

> **In fiscal 1983, approximately $1,768,689,000 in federal contracts were awarded to Minnesota businesses. Of this amount, approximately $154,682,000 was awarded directly to small businesses in the state. (In addition, a portion of the contract dollars awarded to large businesses likely were subcontracted to small businesses in the state, according to Minneapolis SBA officials. No data are regularly maintained on such subcontracts, however.)**
>
> (Note: Data for fiscal 1984 will be available in approximately April, 1985.)

The Minnesota SBA office provides information and referral services to small businesses interested in federal procurement. In addition, it sponsors general and specialized procurement conferences at which representatives of federal contracting agencies are present to explain their specific procurement programs and needs.

> **The Minneapolis SBA office estimates it distributes approximately 2500 procurement information packets annually. That office sponsors nine or ten procurement conferences each year, drawing approximately 5000 attendees.**

Subcontract Assistance

Many federal contracts require the prime contractor to obtain the participation of small businesses as subcontractors. Subcontract specialists within the SBA's regional and Minneapolis district office assist PCRs in federal procurement installations to review subcontracting plans for small business participation, assist small businesses in discovering and expanding subcontracting opportunities; work with large prime contractors to identify qualified small business subcontractors and conduct subcontract compliance evaluations. Because of proximity, SBA officials in Minnesota are in a better position than Chicago regional staff to become familiar with the capabilities of local small businesses, and thus promote their participation in the federal procurement process.

Procurement Automated Source System (PASS)

PASS is a centralized, computer based inventory and referral system of small businesses interested in being a prime or subcontractor for federal procurement purposes. Businesses interested in being listed in the PASS data base register with the SBA. Names of these firms, type of business, capabilities, and ownership data are then available to federal procurement officers and prime contractors should they be interested in contracting with small businesses.

> **Approximately 2500 Minnesota businesses were registered with PASS as of mid-January, 1985.**
>
> (Note: SBA does not maintain data on firms which obtained federal contracts or subcontracts as a result of registering with PASS.)

Certificates of Competency

If a federal contracting officer proposes to reject the bid of a small business which is a low bidder because the contracting officer questions the firm's ability to perform the contract, the firm may request the SBA to certify its competency.

The SBA notifies the contracting officer of the purchasing agency, and a team of financial and technical experts is assigned to review the firm's potential. If the firm is found to be responsible, a Certificate of Competency is awarded. The Certificate is conclusive on questions of responsibility and the contract is awarded. If the Certificate is not awarded, regular assistance programs of the SBA may be available to strengthen the firm's capability.

> **Six Certificates of Competency, involving contracts totalling approximately $715,000, were awarded to Minnesota firms in fiscal 1984. In fiscal 1983, ten Certificates of Competency, involving contracts of slightly over $3 million, were awarded to Minnesota firms.**

Surety Bond Guarantee Program

The surety bond guarantee program authorizes SBA to guarantee sureties participating in the program up to 90 percent of the loss incurred as a result of the small business principal's breach of the terms of a bid bond, payment bond or performance bond. A small business seeking a bond guarantee must certify that the bond is required in order to bid on a federal contract or to serve as a prime contractor or subcontractor on a federal contract and that the bond is not obtainable on reasonable terms without the SBA guarantee. The bond guarantee program thus enables small businesses to participate in federal procurement programs in which they likely could not participate without the SBA guarantee.

> **In fiscal 1984, SBA guaranteed 469 surety bonds for small businesses in Minnesota on contracts totalling $28,828,733. In fiscal 1983, 367 performance bonds were issued on contracts totalling $27,166,564.**

Technical Assistance/Small Business Innovation Research

SBA's technical assistance program is designed to help small business concerns obtain government contracts for research and development and to help small businesses obtain the benefits of research and development performed at government expense. This assistance is strengthened by SBA's participation in the Small Business Innovation Research (SBIR) program.

The technical assistance program is carried out by technology assistance officers (TAOs) in SBA regional offices. SBA management assistance officers in the Minneapolis office serve as liaison between the regional office (located in Chicago) and Minnesota businesses seeking assistance. The TAO, in coordination with Minneapolis office, helps the business define its technical problems and needs, locate applicable technology, and, in some cases, shares in the cost of obtaining the data.

The SBIR program is authorized by the Small Business Innovation Development Act (P.L. 97-219). Under this law, federal agencies with an extramural research and development budget in excess of $100 million must establish an SBIR program. Currently, 12 federal agencies are participating in the SBIR program. SBA coordinates and monitors the activity, and, in Minnesota, conducts periodic seminars to assist small businesses in proposal writing and participation in the SBIR program.

Through its SBIR program each participating federal agency develops topics and publishes solicitation announcements describing those topics. SBA also publishes the topics quarterly in a pre-solicitation announcement. Firms or individuals wishing to participate submit their proposals to the soliciting agency, where they are reviewed and evaluated on a competitive basis. Each agency then makes its own award.

The SBIR program involves three phases:

- Phase I proposals are solicited to explore the feasibility of completing research on the topic and to demonstrate the ability of the proposing firm to do high quality research and development work. Phase I awards generally are between $20,000 and $50,000 for approximately a six month effort.

  Phase II funding is based on the results of Phase I. Phase II is the principal research and development effort, with a maximum duration of approximately two years. Awards are based on the scientific and technical merit of the Phase II proposal, the results of Phase I, continued agency need for the project, and available funds. Phase II awards range from $200,000 to $500,000.

  Phase III involves development of commercial applications of the project. Phase III is funded from non-SBIR sources. Federal funds may be used for development of products or processes intended for use by the federal government.

Any for-profit small business concern with 500 or fewer employees can participate in the SBIR program. The principal investigator for each project must spend more than one half of his or her time on the project. During Phase I, at least two thirds of the research or analytic effort must be performed by the proposing firm. During Phase II at least half of the effort must be performed by the proposing firm.

In fiscal 1984, ten Phase I awards involving $433,650, were made to Minnesota firms. Also in that year, four Phase II awards, totalling $1,025,000, were made to Minnesota small businesses. In fiscal 1983, five Phase I awards were made in Minnesota, totalling $225,000.

Also in fiscal 1984, the Minneapolis SBA office sponsored three SBIR conferences, attended by approximately 335 participants. These conferences generally explained the SBIR program and covered such topics as proposal writing, protecting proprietary technology, and sources of assistance and information.

In fiscal 1985, the Minneapolis SBA office has conducted three specialized SBIR conferences, at which representatives of specific federal agencies explain their particular SBIR requirements. Approximately 165 persons have attended these specialized conferences.

SMALL BUSINESS INVESTMENT COMPANIES
AND
MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANIES

Small Business Investment Companies (SBICs) are privately owned, SBA licensed and regulated companies whose primary purpose is to provide equity capital and long term financing to small firms. To provide leverage for the SBIC's funds, SBA may lend funds to the SBIC or guarantee the SBIC's debentures. SBICs may also provide management assistance to small business concerns.

Minority Enterprise Small Business Investment Companies ("MESBICs" or "301(d) licensees") are SBICs authorized solely to assist small firms owned and operated by socially or economically disadvantaged firms.

> **SBICs are licensed and regulated by SBA's Washington, D.C. office. Data on SBIC or MESBIC activity in Minnesota must be obtained from the Washington office. SBA officials in Minnesota estimate that SBIC funds are leveraged by SBA at a ratio of three SBA dollars to one SBIC dollar. They further estimate that approximately 60 to 65 percent of investments by SBICs licensed in Minnesota are made in Minnesota firms.**
>
> **SBICs licensed in Minnesota are:**
>
> - **Consumer Growth Capital, Inc.** (Minneapolis)
> - **Control Data Capital Corporation** (Minneapolis)
> - **Eagle Ventures, Inc.** (Minneapolis)
> - **FBS Venture Capital Company** (Minneapolis)
> - **First Midwest Capital Corporation** (Minneapolis)
> - **North Star Ventures, Incorporated** (Minneapolis)
> - **Northland Capital Corporation** (Duluth)
> - **Northwest Venture Partners** (Minneapolis)
> - **Norwest Growth Fund, Inc.** (Minneapolis)
> - **P.R. Peterson Venture Capital Corp.** (Minneapolis)
> - **Pathfinder Venture Capital Corp.** (Minneapolis)
> - **Retailers Growth Fund, Incorporated** (Minneapolis)
> - **Shared Ventures, Inc.** (Minneapolis)
> - **Threshold Ventures, Inc.** (Minneapolis
>
> **One MESBIC is licensed in Minnesota:**
>
> - **Control Data Community Ventures, Inc.** (Minneapolis)

MINORITY SMALL BUSINESS AND CAPITAL OWNERSHIP DEVELOPMENT

Section 8(a) Program

Section 8(a) of the Small Business Act authorizes the SBA to contract with other federal agencies to supply the goods and services those agencies need. SBA then subcontracts actual performance of the work to small businesses owned and controlled by socially and economically disadvantaged individuals (Section 8(a) firms). Through this program, government procurement can be directed to areas of specific economic need, fostering long term employment in those areas.

The Minneapolis office certifies the eligibility of firms to participate in the Section 8(a) program. It "markets" the program to qualified small businesses in Minnesota and promotes the qualifications of Minnesota firms to SBA officials in the Chicago regional office. The regional office is responsible for executing the actual contract between SBA and the Section 8(a) firm. The Minneapolis office also assists Section 8(a) firms in preparing proposals for regional office consideration.

Examples of Section 8(a) programs in Minnesota include numerous construction projects, a garment-cutting enterprise on the White Earth Indian Reservation, and a manufacturing firm on the Fond du Lac Reservation.

> **In fiscal 1984, SBA awarded subcontracts to Section 8(a) firms totalling approximately $5 million. In fiscal 1985, SBA officials anticipate such contracts may approach approximately $15 million.**

Business Development Expense

Business development experse (BDE) funds are made available by SBA for the purpose of assisting a Section 8(a) business to perform a specific Section 8(a) subcontract. BDE funds may be used to supply the difference between fair market price of the subcontract and the (higher) reasonable price required by the Section 8(a) subcontractor attributable to inefficiencies of scale, lack of access to credit on reasonable terms, and other factors that, because of the 8(a) firm's size, impair its ability to compete for federal subcontracts. BDE funds also may be used to purchase equipment or defray engineering, developmental, training or other costs necessary to perform the Section 8(a) contract, but which the Section 8(a) firm cannot incur without adversely affecting its financial condition.

> **SBA awarded $82,817 in BDE funds in fiscal 1984 and $6845 in fiscal 1983 in Minnesota. Both awards were made to same** organization.

Development Assistance (Section 7(j) Program)

Section 7(j) of the Small Business Act authorizes SBA to provide financial assistance to public or private organizations to deliver technical or management assistance to Section 8(a) firms. Assistance may include planning, research, market research, identification and development of new business opportunities, furnishing business counseling, management training, and legal and other related services.

> **In fiscal 1984, SBA awarded $80,000 under the Section 8(a) program to provide accounting services to designated 8(a) enterprises. Approximately 40 Minnesota companies will be assisted through this program.**

Minority Enterprise Small Business Investment Companies (MESBICS)

A MESBIC, like a SBIC, is a privately owned and operated company which has been licensed by the SBA to provide equity capital, long term loans and management assistance to small firms. MESBIC are authorized solely to assist small firms owned and operated by socially or economically disadvantaged individuals. Examples of services provided by a MESBIC include assistance in developing business plans, loan packaging, financial counseling, accounting, and obtaining surety bonds.

> **There is one MESBIC currently licensed in Minnesota: Control Data Community Ventures Fund** (Minneapolis).

Other Programs

Section 8(a) of the SBA Act permits SBA to authorize advance payment to Section 8(a) subcontractors and to issue letters of credit to disburse advance payments. This program is not utilized in Minnesota, in large part because passage of the Prompt Payment Act and SBA management assistance programs have improved these firms' ability to manage their cash flow and thus have made the program unnecessary.

Similarly, Section 8(a) authorizes SBA to arrange for waiver of bonding requirements under certain circumstances. This program is not utilized in Minnesota because the SBA bond guarantee program, discussed in the Procurement section of this report and for which

Section 8(a) businesses are eligible, has made bond waiver under the Section 8(a) program unnecessary in most cases.

Section 8(a) firms and other businesses owned by socially and economically disadvantaged individuals also are eligible for other SBA programs such as Section 7(a) and 503 loans, procurement assistance, the certificate of competency program and the surety bonding program.

> In fiscal 1984, SBA approved 13 business loans to minority firms in Minnesota totalling $1,700,000 (SBA share). In fiscal 1983, 11 business loans were approved totalling $858,000 (SBA share).
>
> In addition, two economic opportunity loans, totalling $57,000 were made to socially or economically disadvantaged business owners in Minnesota in 1984. No such loans were made in fiscal 1983.
>
> Contracts to Minnesota minority-owned firms (in addition to Section 8(a) subcontracts) in fiscal 1983 totalled $6,023,000. Data for fiscal 1984 are expected to be available by April, 1985.

MANAGEMENT ASSISTANCE

SBA management assistance programs are designed to improve and strengthen the management capabilities of small businesses, thereby reducing the number of business failures attributable to managerial deficiencies. Management assistance programs sponsored by SBA include:

- Counseling programs provided by SCORE/ACE volunteers, Small Business Institutes and Small Business Development Centers
- Training Programs
- Publications
- Special emphasis areas including: international trade, women's issues, veterans issues, SBIR programs and procurement matters.

The Minneapolis SBA's management assistance program is designed to provide a "resource management function" by which quality resources (counselors, seminars, etc.) are coordinated by SBA to provide the broadest range of programs and assistance to small businesses.

Counseling Programs

Individualized management and technical assistance is provided at no charge to owners of small businesses and persons interested in starting a business.

> **SCORE/ACE volunteers** are experienced retired or active business people who provide individualized counseling on a broad range of management problems. SBA reimburses out of pocket expenses incurred by SCORE/ACE volunteers. SCORE/ACE organizations also conduct "going into business" workshops on a periodic basis in selected areas of the state.
>
> > **SBA estimates approximately 2400 individuals received SCORE/ACE counseling in Minnesota in fiscal 1984. In fiscal 1983, approximately 3000 individuals received SCORE/ACE counseling. There are 22 SCORE/ACE offices in Minnesota. SBA reimbursement to SCORE/ACE counselors for out of pocket expenses in fiscal 1984 was approximately $27,000.**
>
> **Small Business Institutes** are cooperative programs among collegiate programs of business administration, members of the business community and SBA. Graduate and upper division

level students under faculty supervision provide counseling assistance to small business owners and managers. The program operates under formal contracts or voluntary agreements between SBA and the schools.

> **SBA estimates that in fiscal 1984, approximately 95 individuals received counseling through small business institute programs in Minnesota. In fiscal 1983, 179 individuals received such counseling.** (According to SBA, the number of persons receiving counseling dropped because the maximum dollar participation by SBA per case increased while the total dollar appropriation--approximately $83,000--remained fixed.)
>
> **There are ten small business institutes in Minnesota. They are located at:**
>
> **Bemidji State University**
> **Bethel College (St. Paul)**
> **Mankato State University**
> **Moorhead State University**
> **St. Cloud State University**
> **St. Mary's College (Winona)**
> **St. Olaf College (Northfield)**
> **College of St. Thomas (St. Paul)**
> **University of Minnesota - Duluth**
> **Winona State University**

Small Business Development Centers are a consortium of resource centers, typically located at colleges in the state, where information, counseling and assistance are coordinated and disseminated to persons who plan to start a small business, or are presently operating a small business.

The SBDC provides education and training opportunities covering a wide range of business topics; in-depth counseling; assistance in developing business plans and loan packaging; workshops and seminars; assistance to minorities and women, and referral system linkage with other small business assistance organizations.

SBA contracts with a "lead school" which subcontracts with participating SBDCs.

> **The SBA SBDC contract in Minnesota for fiscal 1985 is $763,635. In fiscal 1984, it was $583,000.**
>
> **SBA estimates approximately 2400 individuals received counseling services through Minnesota SBDCs in fiscal 1984. In fiscal 1983, approximately 1600 individuals were counseled through Minnesota SBDCs.**

SBDCs are located at:

College of St. Thomas (St. Paul) ("Lead School")
Bemidji State University
Brainerd AVTI
Faribault Small Business Development Center
Mankato State University
Moorhead State University
Red Wing AVTI
St. Cloud State University
Southwest State University (Marshall)
University of Minnesota (Duluth)
University of Minnesota - Agricultural Extension Service (St. Paul)
University of Minnesota (Minneapolis)
Minnesota Project Innovation (Minneapolis)

Training Programs

SBA training programs present the principles and skills of small business management to persons who own or manage a small business, and to those who intend to try. Four types of training are offered: courses, conferences, problem clinics for persons already in business and prebusiness workshops for those who intend to go into business. To provide a wide variety of management subjects in many locations, SBA cosponsors training with educational institutions, local business organizations and other government agencies.

> In fiscal 1984, SBA sponsored 265 training programs in Minnesota, attended by approximately 11,430 individuals. In fiscal 1983, an estimated 11,200 individuals attended such training programs.
>
> In addition, an estimated 1227 persons attended loan information seminars conducted approximately three times a week at the Minneapolis SBA office.
>
> In fiscal 1984, SBA provided approximately $5000 to subsidized business owners' use of Control Data Corporation's PLATO program. (Users may go to Control Data learning centers in Roseville, Bemidji or Edina, MN, to use PLATO's programmed learning modules on topics such as purchasing, marketing, taxes, depreciation and contract bidding.)

Publications

The Minneapolis SBA office distributes SBA-produced business management publications on a variety of topics. There are four series of free publications available through the Minneapolis SBA office: Management Aids for Small Manufacturers, Small Marketers Aids, Small Business Bibliographies, and Counseling Notes. These 6-8 page leaflets cover marketing and manufacturing business information and bibliographical information on specific trades and industries. A more detailed series of management publications explaining selected business subject such as "cash management" and a series on starting and managing various types of businesses are available for purchase through the Superintendent of Documents, Washington, D.C.

Special Emphasis Areas

In addition to day-to-day contact with small business owners and potential small business owners, and coordination of counseling and training activities performed by SBDCs, SBIs and others, the four management assistance officers assigned to the Minneapolis SBA office focus on five special emphasis areas:

- International Trade
- Women Business Owners
- Veterans
- Procurement
- SBIR and other technology-oriented programs

International trade. SBA's international trade program is designed to encourage and assist existing and prospective small business exporters to develop their international marketing potential. The Minneapolis office coordinates efforts by state agencies, the U.S. Commerce department and international business programs at state universities in this regard, and cosponsors seminars on international trade topics.

> **In fiscal 1984, international trade seminars sponsored by the Minneapolis SBA office attracted over 850 participants.**

Women Business Owners. The management assistance officer responsible for women's programs within the Minneapolis SBA office serves as the agency's contact person for women business owners and coordinates conferences and workshops addressed to the special concerns of this group.

Most recently, the Minneapolis SBA cosponsored and coordinated a two-day "Women's Business Ownership Trade Fair and Conference." The conference was one of a series of nationwide conferences designed to provide educational assistance to present and prospective women entrepreneurs in business management, procurement and financial planning. Funds raised through the conference were used to establish a Minnesota Women Business Owners Education Council. That organization will assume responsibility for planning future workshops, conferences, and training opportunities. SBA, in conjunction with the SBDC at the College of St. Thomas, is planning a 15-hour program, "Focus on Survival," aimed at women owners and managers of small businesses that are in the early growth stage. The program is designed to identify and deal with issues critical to business survival during the first three years.

Another program is planned for April, 1985, in Red Wing.

> Approximately 1840 persons attended the Minnesota Women Business Owners Conference and Trade Fair in September, 1984.
>
> Approximately 75 individuals attended a one-day "Women in Business" workshop in Brainerd in August, 1984.
>
> An addition 3100 women attended other SBA-sponsored seminars in fiscal 1984.
>
> Approximately $21,000 was made available following the 1984 Women Business Ownership Conference to provide seed money for the Women Business Owners Education Council.
>
> Approximately 2350 requests for information on women's programs were filled by the Minneapolis SBA office in fiscal 1984.

Veterans Programs

The veterans liaison officer in the Minneapolis SBA office is the contact person for veterans seeking information and assistance on going into and remaining in business. This person coordinates SBA's involvement in seminars and workshops aimed at veterans, and works within the SBA and with other groups to service the special needs of veterans. One such example is the Veterans Business Resource Council, which consists of representatives of SBA, the Vietnam Veterans Leadership program, SBDCs, and representatives of the American Legion, VFW and similar veterans groups. This group assists the Minnesota SBA to focus its veterans efforts on issues important to veterans.

> In fiscal 1984, SBA sponsored three business conferences for veterans, attended by approximately 170 veterans. In fiscal 1983, two such conferences were held, attracting about 165 veterans.
>
> In fiscal 1984, SBA filled approximately 300 requests for information on veterans programs.

Procurement and SBIR Programs

These programs are discussed in the Procurement section of this report.

ADVOCACY

The SBA's Office of Advocacy represents small business concerns before federal agencies. The Office of Advocacy is located in Washington, D.C., and most advocacy functions are now performed by that office and four regional offices.

However, the Minneapolis SBA office has retained some advocacy functions. These activities include: facilitating meetings of groups representing small business concerns, (e.g., MACI, NAWBO); distributing information on issues important to small business (e.g., product liability) published by the Office of Advocacy; encouraging education of small business owners on current issues (e.g., regulatory reform, monetary reform) and otherwise informing small businesses within the state about activities, programs and issues of common concern.

Advocacy functions performed by the Washington office include dissemination of informtion on federal legislation (e.g., the Regulatory Flexibility Act, Equal Access to Justice Act and Prompt Pay legislation); economic research of interest to small business, and assisting small businesses that encounter problems in dealing with other federal agencies.

SERVICE

No examination of the impact of SBA in Minnesota would be complete without addressing the volume of activity, service, and liquidation activities of that agency. While the following list is not comprehensive, it does provide a picture of the types of activities required to support the financing and management assistance services of SBA.

Volume of Activity

In fiscal 1984, the Minneapolis SBA office received 640 business loan applications. In fiscal 1983, it received 673 business loan applications. Of these submissions, 343 applications were approved in fiscal 1984 and 333 applications were approved in fiscal 1983.

The Minneapolis SBA office mailed responses to approximately 6800 inquiries in fiscal 1984. Of these requests, 2400 involved information on women's programs, nearly 300 requested information on veterans programs, and over 100 requested information on PASS.

The Minneapolis SBA office has an authorized staff complement of 38 persons.

Loan Servicing

At the end of fiscal 1984, the Minneapolis SBA office had approximately 4500 business and disaster loans in its portfolio. Of these, approximately 550 business loans and approximately 1700 disaster loans were serviced by that office.

At the end of fiscal 1983, the Minneapolis SBA office had nearly 4900 loans in its portfolio. Of these, 583 business loans and approximately 2000 disaster loans were serviced directly by that office.

There are six staff persons in the portfolio management division of the Minneapolis SBA office.

Liquidation

At the end of fiscal 1984, the Minneapolis SBA office had 211 business loans and 33 disaster loans in liquidation status. SBA records show 160 liquidation cases were closed in fiscal 1984.

At the end of fiscal 1983, the Minneapolis SBA office had 226 business loans and 45 disaster loans in liquidation status. 121 liquidation cases were closed in fiscal 1983.

Five persons are assigned to the liquidation division of the Minneapolis SBA office.

The CHAIRMAN. Governor, thank you very much for your testimony.

No. 1, I am impressed with your taking the time out to come here and testify.

We have also heard another great success story from your State, which is Cray Research.

Governor JOHNSON. Yes.

The CHAIRMAN. They started with a small business loan from the Small Business Investment Co.

I think it is important that after the legislative and executive sides of the argument are heard, that we hear from people such as yourself who have experience in the day-to-day operations of what is going on vis-a-vis small business, and I thank you very much for giving your testimony.

Governor JOHNSON. Thank you, Senator.

We very much appreciate that businesses and Government agencies, as well as many private sector groups that have worked with the SBA, recognize that it is important, but often difficult, to get everybody up to speed on exactly what role the SBA has played over the years. The hearings that you have been making time for are really playing a very important part in this process, and we thank you for it.

The CHAIRMAN. Thank you very much.

Senator Dixon.

Senator DIXON. Mr. Chairman, I would just like to echo your remarks about the very excellent presentation by Governor Johnson. We appreciate it. As a principal cosponsor of S. 408, I am flattered that she would come here at the appropriate time to lend her support to this very good legislation, and we thank her.

Governor JOHNSON. Thank you.

The CHAIRMAN. Senator Kerry.

Senator KERRY. Just as a former Lieutenant Governor and very recently so, I welcome you here. [Laughter.]

Governor JOHNSON. Thank you.

The CHAIRMAN. Thank you very much.

I ask unanimous consent that a statement by Ned Guthrie, legislative director for the American Federation of Musicians, be printed in the record at this point.

[The prepared statement of Mr. Guthrie follows:]

Guthrie and Beane Music Co.
"Everything for the School Musician"

[redacted]

PHONE: 342-6121

912 QUARRIER ST.
CHARLESTON, WEST VIRGINIA 25301

March 5, 1985

The Honorable Lowell P. Weicker
United States Senate
303 SHOB
Washington, D. C. 20510

Dear Senator Weicker:

I watched you, Senator Weicker, on C-Span during the Senate Committee Hearings on Budget Cutbacks. First off, I respect you for your Chairmanship of the Committee on Small Business and your stance on SBA in general.

You are aware of my activities as National Legislative Director and Lobbyist for the American Federation of Musicians, a post I have held for several years, since retiring from a retail music business in which I was a founder and co-owner for 22 years of the general purpose Guthrie and Beane Music Company.

The Small Business Administration approved a loan to us in the amount of $15,000, at 4% interest, on June 2, 1964. The date of paying off the loan successfully was August of 1970. This information can be verified by the regional office of SBA in Clarksburg, WV. The SBA loan came at a time when our store was expanding from a two-man operation (Jim Beane, trumpet player in my weekend dance band and myself, as partners in a small teaching-studio store). The loan helped us to expand the teaching studios and acquire important franchises on musical instruments, and to maintain sales and service of same within a radius of 160 miles. The SBA loan enabled us to improve until there were fourteen employees, including salesmen, instrument repairman, piano tuner, electronic repairman, and five music teachers. Additionally, the Ned Guthrie Orchestra was headquartered there, as was the Don Osborne Orchestra, for the purpose of correspondence, etc.

Guthrie and Beane could not get local banks in Charleston, WV to participate in the SBA program and we gave up on the idea for a couple of years. But SBA took a chance on us and what talents and assets we did have in fixtures and inventory and made us a direct loan. It was the priming of the pump that made a small operation become successful. After that the local banks wanted our floor plan business as well as our paper. January 1, 1974, at the end of a lease period with our landlord, we sold our business profitably to another music company and it is still going strong in our 100% location. I began to devote full time to Repeal of the LEA Act by the U. S. Congress and became a lobbyist for musicians.

I am using left-over stationery, etc., from Guthrie and Beane Music Company to make you aware of how the SBA helped so many of us (nine families) to benefit in a successful music store and studio.

Senator Weicker, I hesitate to send this to you as I do not really know how important it would be, but I just flat out do not think that David Stockman knows what he is talking about concerning SBA. I have a complete audited set of books on the entire history of Guthrie and Beane Music Company of 22 years which would be available, if so desired, to show an actual case history of a Small Business Administration loan.

If you think any of this information would be appropriate to the SBA review, please use it as you will.

Sincerely,

Ned H. Guthrie

Ned H. Guthrie
(formerly Guthrie and Beane Music Company)
209 Hayes Avenue
Charleston, WV 25314

The CHAIRMAN. I also ask unanimous consent that a statement by the Governor of Wyoming, Ed Herschler, and a resolution adopted by the National Governors' Association Committee on Economic Development be printed at this point in the record.

[The prepared statement of Governor Herschler follows:]

STATEMENT OF

ED HERSCHLER, GOVERNOR OF WYOMING

The State of Wyoming is acutely aware of the proposal to abolish the Small Business Administration and its programs, in their entirety. We are also very much aware of the need for federal budget cuts and constraints in spending. But to blatantly single out the entire Small Business Administration will have a negative impact on growth and economic development activities, not just in Wyoming, but in the entire United States.

I am sure that you are all aware that small businesses in America today are the leading contributor toward the creation and retention of jobs. This is truly a result of entrepeneurship and our system of free enterprise. However, to force the states to try and pick up the pieces if the SBA is gone, could drive us all back to square one.

Granted, a few states do have some very innovative financing tools available for business and industry. And, a few states have also managed to build these programs with the use of taxpayers' money at extremely high risk and with little to no guarantee on return. Some are targeted so tightly that the only way a business can qualify for the loan is to be in a position as to not need the loan.

In Wyoming, our small business financing programs have a little different twist to them. In taking inventory of the state and its economic needs, it is clear that small businesses are the state's dominant economic force. Most Wyoming businesses are small by national standards and are heavily dependent on long-term fixed rate capital.

Lenders have generally avoided small commercial loans because of paper work, perception of greater risk and, if they do make the loan, it is generally on a floating rate basis - reflective of the increasing emphasis on spread rate banking with both costs of funds and yields on floating loans.

Within Wyoming, we have three strong programs that have proven to be beneficial to the people of our state, effective for our small businesses' economy and very innovative for the financing community. These programs are the Wyoming Retirement System participation in small business financing; the State Treasurer's Small Business Assistance Act; and of course, the Small Business Administration's program, administered through our District Office in Casper, Wyoming.

The Wyoming Retirement System pension fund participation in small business finance has offered both exciting challenges and new opportunities to small business in our state. This pension fund is explicitly prohibited from purchasing common stocks, warrants or other forms of residual interest. Therefore, the system focuses its purchases only on notes, bonds and debenture, plus securities that are guaranteed directly or indirectly by the United States government. Enter the Small Business Administration.

Bankers originating SBA loans can sell the guaranteed portion at yields related to the U. S. Treasury bond market at spreads dependent upon the requested length of the commitment period.

In addition, the Retirement System has developed an agreement to provide a pooling mechanism for smaller loans. SBA loans of $250,000 or more can be sold directly to the Retirement System. Smaller loans are pooled by an industrial corporation using pension fund investments.

This mechanism provides the pension fund with a way to accommodate purchase of funding of SBA loans of any size. Since initiation of the program in 1982, eight such pools have already been funded, and a total of $25 million in SBA guaranteed loans have been purchased for the $500 million Reitrement System portfolio at yields between 10 3/4 percent and 16 percent.

Wyoming's State Small Business Assistance Act, only a year old, has been touted as one of the most innovative programs offered by any state for small business in America today.

In 1984, the Wyoming legislature authorized the State Treasurer to invest $50 million in small businesses in Wyoming, through the purchase of portions of Small Business Administration and Farmers Home Administration Business and Industry loans.

Investment by the State Treasurer is limited to the portion of the loan that is guaranteed by SBA through their 7a and 502 programs and the Farmers Home Administration Business and Industry program.

Interest rates are set at three percent below the long-term Treasury Bond rate, but not less than nine percent. These reduced rates run for the first five years of the loan, at which time the rates will be adjusted to 1 1/2 points over prime. The reduced net cost of these loans are an attractive inducement to small business development and expansion in Wyoming.

Further benefits to the state are that we do not get into the business of industrial lending. Since businesses must first meet the credit requirements of local lending institutions, as well as SBA, extensive credit restrictions are already in place.

During this first year of the program, which actually entailed about eight months of full program activity, the Wyoming Small Business Assistance Act invested $16 million and was influential in creating or retaining over 700 new jobs.

As you can see, these state programs are directly tied to the Small Business Administration. They cannot, and will not work without that agency. The three entities combined together offer a significant strategy that provides a safe and effective way to help increase the availability of long-term financing for small businesses seeking growth, expansion and stability.

Only recently has the State of Wyoming had the privilege of multiple programs. Before 1982, and the Retirement System Pension fund, and 1984 with the state's Small Business Assistance Act, all that was available in the State of Wyoming was the Small Business Administration. But this office, which opened in 1962, has far and away outdistanced other district offices in terms of the number of loans made and dollars financed.

The Casper SBA District Office, on its own, does an average of $25-$30 million of guaranteed loans a year, with an average cost per job of approximately $18,000. Normally, in Wyoming, the ratio of dollars to jobs is $22,000 to $25,000. This is due primarily to high wage levels in the mineral industry.

To date, the Small Business Administration has packaged over 6,000 loans, to the tune of $518 million in Wyoming. In the past, the SBA's average participation per loan has hovered near $80,000; however, in 1984, that figure jumped to $140,000.

There are 110 banks in Wyoming that have participated with SBA and their programs. Considering that there is only a total of 114 banks in the state, mostly very small, with an average lending limit of $30,000, the Small Business Administration has effectively offered our financial institutions the liquidity needed.

This combined public/private partnership has succeeded in maintaining one of the highest small business loan ratios in the United States.

These programs point out several important characteristics of investments and loans which are attractive to managers and recipients of public and private financing firms. In addition to safety, high yield and capital appreciation potential, these characteristics include providing an additional source of funds for small business.

While you are contemplating the abolishment of the Small Business Administration, I urge you to consider the aggressive marketing, the private sector participation, the spectrum of financing tools available, and the performance goals established, specific to the number of jobs created, dollars of financing generated and the number of businesses assisted by this agency. The Small Business Administration has offered more toward the development and growth of small businesses in Wyoming and the United States than any other federal agency today. The Small Business Administration is an effective agency which performs a needed and valuable role in promoting and facilitating economic growth and development. Abolishing the SBA during today's highly volitile economic times could be a mistake that will cost the nation dearly in the years to come.

The CHAIRMAN. Our next witnesses will form the first panel: The Honorable J. Michael Houston, mayor of Springfield, IL; and the Honorable Ralph A. Johnson, mayor of Warner Robins, GA.

Mayor Houston, good morning to you.

Mr. HOUSTON. Good morning.

The CHAIRMAN. And, Mayor Johnson, a good morning to you.

Senator DIXON. Mr. Chairman, may I have the honor and pleasure of introducing an old friend to this panel, on his birthday, Mr. Chairman. He is advised that, like the President, he is 39 and holding.

I am pleased to introduce my good friend, the Honorable J. Michael Houston, who has been mayor of Springfield, IL, since 1979.

Mr. Houston is appearing on behalf of the U.S. Conference of Mayors to testify before the Senate Small Business Committee concerning the future of the Small Business Administration.

Mr. Houston is eminently qualified to discuss the Small Business Administration because he has been very active on small business matters for a number of years and is very familiar with the relationship of the SBA programs to economic development in Illinois.

In addition to his association with the U.S. Conference of Mayors, he serves as president of the Illinois Municipal League, which represents a great number of Illinois communities.

It is my pleasure, Mr. Chairman, to introduce to you Mayor Houston of Springfield, IL.

The CHAIRMAN. Thank you, Senator.

Mayor Houston.

STATEMENT OF HON. J. MICHAEL HOUSTON, MAYOR OF SPRINGFIELD, IL, ON BEHALF OF THE U.S. CONFERENCE OF MAYORS

Mr. HOUSTON. Thank you, Senator Dixon.

Senator Weicker and members of the Senate Committee on Small Business, I am J. Michael Houston from Springfield, IL.

Thank you for providing me this opportunity to testify before you on behalf of the U.S. Conference of Mayors, which represents the 850 American cities with populations exceeding 30,000. We believe the subject of this hearing is one of extreme importance to America's cities.

Our organization has spent the past 53 years working jointly with Congress and the administration to ensure that the needs and interests of America's cities, and their citizens, are considered in the development of national public policy.

Therefore, you can understand why I am here today. The decision Congress reaches regarding the future of the Small Business Administration will be felt in every State in our Nation. Any action to eliminate the SBA would slam the door on long-term financing for small and medium-sized businesses, just when those businesses can least afford that door to be closed.

The U.S. Conference of Mayors has long recognized that small businesses are the backbone of our communities and that the fortunes of our cities are directly linked to our small businesses.

Because of that fact, we adopted a policy resolution in 1979 which stressed the interaction of small business development and economic development in our cities. It was clear then, as it is today, that the Small Business Administration must be viewed as an integral part of the Federal effort to aid cities.

Since small businesses are responsible for 80 percent of all jobs created, and 50 percent of all innovation, the U.S. Conference of Mayors has established a Mayors' Task Force on Small Business Development, on which I serve.

That committee has sponsored workshops on small businesses and has been responsible for the development of a center for entrepreneurship, which allows us to provide information and direct technical assistance to cities in their efforts to encourage small business development.

Our efforts will be meaningless, however, if the SBA is eliminated. No amount of technical assistance will compensate for the financing void which would be created.

It is important for us to review just how essential the SBA's financing programs have been to the economic development efforts in America's cities. Eliminating the SBA would send a shock wave rippling through our economy destroying the most successful public-private partnership ever created, the SBA 503 program.

To date, there have been more than 3,800 SBA 503 loans approved, totaling $764 million. Those public dollars were leveraged with more than 1.3 billion private dollars, resulting in over 95,000 new jobs.

In Illinois, the results have been equally impressive. Besides my involvement with the U.S. Conference of Mayors, I serve as president of the Illinois Municipal League, which represents over 900 Illinois communities and approximately 84 percent of the State's 11 million people.

The 503 program has been responsible for 2,700 new jobs in Illinois, resulting from 120 503 loans. We have leveraged 27 million public dollars with 41 million private dollars, and that economic development has been throughout the State from Chicago to some of our smallest communities.

Across America, the 503 program has met that same success. Through it, SBA has emerged as a full and equal partner with our financial institutions in encouraging economic development.

The 503 program also represents one of the most flexible financing programs available. In my community alone, it has been instrumental in financing small businesses involved in agriculture, retailing, manufacturing, construction, and the service industry.

Springfield's eight approved projects and two pending business expansions will mean 200 new jobs for my community—jobs which would not have occurred without the Small Business Administration.

I am going to provide you with two examples from my community of projects assisted by the 503 program, projects which created 80 jobs.

We used the 503 program as a key component in financing the full-scale renovation of a century-old downtown hotel. Although the 503 portion of the project represented only $300,000 of a $2 million investment, it was instrumental in creating 70 new jobs. That is a job creation cost of less than $4,300 per job, for a project which facilitated much-needed revitalization within our central business district.

We also used the 503 program and the 7(a) guaranteed loan program to assist a local manufacturing company expand into a larger facility and purchase new equipment. Because the company's sales doubled last year, our area lenders wanted the company to wait at least another year before expanding to make certain its increased sales would continue.

The SBA analyzed the company's growth, saw the increased sales were no fluke, and took a chance on the business. I am happy to say that the company has continued its phenomenal growth, growth made possible by the Small Business Administration. Ten new jobs were created by that expansion.

Our successes are not unusual and have been matched in cities across the country. Cleveland, Jacksonville, Kansas City, Portsmouth, St. Paul, and Wichita are just a few of the other communities which have formed an important partnership with the Small Business Administration.

It is evident that the SBA and its financing programs have been responsible for creating thousands of jobs now that might not have been created for several years, if ever.

Eliminating the SBA would strike a significant blow against America's small businesses. It would also have a devastating effect on the continued economic recovery and revitalization of our cities.

Currently, my office and other city offices across our country work hand-in-hand with the SBA putting together successful development projects. These are not weak projects which are doomed to fail, as many characterize SBA loans. Instead, they are strong projects destined to succeed and to create new jobs.

As an indication of the types of loans the new SBA is making, I ask you to again look at my city, Springfield, IL. Of the eight 503 loans approved since May 1982, no loan has ever been in default. In fact, not one of our eight projects has made a single late payment.

Make no mistake. Without the Small Business Administration, few, if any, of these projects could have happened. The long-term, fixed-rate financing offered by the SBA is not otherwise available. Most financial institutions are not making long-term, fixed-rate loans. Therefore, the elimination of the SBA would create a financing void which could not be filled.

I am not here today to argue that all current SBA programs are good ones. Some are not. However, Senate bill 408 would save the SBA programs which have been responsible for creating almost 200 jobs in my community, 2,700 jobs in the State of Illinois, and 95,000 jobs across America. At the same time, it would eliminate SBA programs which have, for years, made bad loans with little chance of repayment.

I believe Senate bill 408 represents a comprehensive solution. It addresses the immense problem of the Federal deficit while being responsive to America's small businesses.

The U.S. Conference of Mayors hopes that Congress will recognize the important partnership that has been established between America's cities and the SBA and that you will work to strengthen that partnership, not eliminate it.

Thank you.

[The prepared statement of Mr. Houston follows:]

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STATEMENT

BY

J. MICHAEL HOUSTON

MAYOR OF SPRINGFIELD, ILLINOIS

ON BEHALF OF

THE U.S. CONFERENCE OF MAYORS

BEFORE THE

COMMITTEE ON SMALL BUSINESS

U.S. SENATE

MARCH 7, 1985

Senator Weicker, members of the Senate Committee on Small Business, I am Mayor J. Michael Houston from Springfield, Illinois.

I would like to thank you for providing me with this opportunity to testify before you today representing the thoughts of the U.S. Conference of Mayors. We believe the subject of this hearing — the future of the Small Business Administration — is one of extreme importance to America's cities.

The United States Conference of Mayors represents the approximately 850 American cities with populations exceeding 30,000 people.

Our organization has spent the past 53 years working jointly with Congress and the Administration to insure that the needs and interests of America's cities, and their citizens, are considered in the development of national public policy.

Therefore, I am sure you will understand why I am here before you today. The decision that Congress reaches this session regarding the future of the Small Business Administration will be felt in every state in our Nation. Any action to eliminate the S.B.A. would serve to slam the door on long-term financing for small and medium-sized businesses, just when those businesses can least afford for that door to be closed.

My testimony today is not the first time our organization has taken a position on small business development.

The U.S. Conference of Mayors has long recognized that our small businesses are, indeed, the backbone of our communities, and the fortunes of our cities are directly linked to the fortunes of our small businesses.

Because of that fact, we adopted a policy resolution in 1979 which called for the interaction of small business development and economic development in our cities. It was just as clear then, as it is today, that the Small Business Administration must be viewed as an integral part of the federal effort to aid cities.

Since small businesses are responsible for 80 percent of all new jobs created, and 50% of all new innovation, the U.S. Conference of Mayors has established a Mayors' Task Force on Small Business Development, on which I serve.

That committee has sponsored workshops on small business and has been responsible for the development of a center for entrepreneurship, which will allow us to provide information and direct technical assistance to cities in their efforts to encourage small business development.

Our efforts will be meaningless, however, if the S.B.A. is eliminated, as called for in the Administration's budget proposal. All the technical assistance in the world will not compensate for the financing void which would be created if the S.B.A. is disbanded.

It is important to review, just how essential the S.B.A.'s financing programs have been to economic development efforts in America's cities. The two are closely linked. Eliminating the S.B.A. at this time would send a shock wave rippling through America's economy which would destroy the most successful public-private partnership which has ever been created. I am speaking of the S.B.A. 503 program.

To date, there have been more than 3,800 S. B. A. 503 loans approved, totalling $764 million. Those "public" dollars were leveraged with more than $1.3 billion "private" dollars for a combined economic impact exceeding $2.1 billion. Almost 70,000 jobs have been created through this program alone.

In Illinois, the results have been equally impressive. Besides my association with the U.S. Conference of Mayors, I serve as the president of the Illinois Municipal League, which represents over 900 Illinois communities, and approximately 84% of the State's eleven million people.

I am pleased to say that the 503 Program has been responsible for 2,700 new jobs in Illinois resulting from one hundred twenty 503 loans. We have leveraged $27 million "public" dollars with $41 million "private" dollars for a total of $68 million in economic development -- and that economic development has been across the board, from our largest city, Chicago, to some of our smallest villages and townships.

Across America, the 503 Program has proven to be an unqualified success. Through it, the S.B.A. has emerged as a full and equal partner with our financial institutions in encouraging economic development. That partnership has helped the S.B.A. shed its image as the lender of last resort.

You've probably heard about the success stories of this program. There have been many. The program also represents one of the most flexible financing programs available. In my community alone, the 503 Program has been instrumental in financing small businesses involved in agriculture, retailing, manufacturing, construction and the service industry. Springfield's eight approved projects and two pending business expansions will mean 200 new jobs for my community -- jobs which would not have occurred without the Small Business Administration.

I am going to provide you with two local examples from my community of projects assisted by the 503 Program — projects which created 80 jobs.

We used the 503 Program as a key financing component in the full-scale renovation of a 100-year-old downtown hotel. Although the 503 portion of the project represented only $300,000 of a $2 million investment, it was instrumental in creating 70 new jobs. That's a job creation cost of less than $4,300 per job, for a project which facilitated much needed revitalization within our central business district.

We also used the 503 Program and the 7(a) guaranteed loan program to assist a local manufacturer expand into a larger facility and purchase new equipment. Because the local company's sales doubled last year, our area lenders wanted the company to wait another year or so before expanding, to make certain the increased sales would continue. The S.B.A. analyzed the company's growth, saw the increased sales were no fluke, and took the chance on the business that the banks had been reluctant to take. I am happy to say that the company has continued its phenomenal growth — growth made possible by the Small Business Administration. Ten new jobs were created by that expansion.

Our successes are not unusual and have been matched in cities across the country. Cleveland, Jacksonville, Kansas City, Portsmouth, St. Paul, Wichita . . . are just a few of the other communities which have also formed an important partnership with the Small Business Administration.

The Cleveland Citywide Development Corporation was established in 1982 to provide the city with a more flexible way to encourage economic development within Cleveland — especially in the form of small business growth.

In addition to its 503 lending activities, Cleveland uses the corporation as a review body for Title IX projects, community development revolving loans, HUD Section 108 loans, and Urban Development Action Grants. The development corporation has made eight 503 deals, representing an investment of $2.5 million. This has resulted in the retention of 150 jobs and the creation of 125 new ones. The 503 program represents about 15 percent of Cleveland's overall economic development effort.

As part of the city's neighborhood revitalizing efforts, the Jacksonville Local Development Company was established by Mayor Jake Godbold to participate in SBA's 502 program. Later it was certified to participate in the 503 program.

The Jacksonville development corporation coordinates SBA funds with CDBG revolving loans, other construction loans, UDAG applications and other sources as a part of a complete economic development program.

Between 1980 and 1984 the LDC has undertaken 73 projects with a total investment of $40 million. Over 1,000 jobs have been created; 1,500 have been retained. The investments have generated $7 million per year (at minimum wage) in new payroll and $487,000 per year in property taxes. There have been nine SBA 7(a) loans, totaling $2 million and creating 46 new jobs, nine 502 loans, totaling $2.5 million and creating 195 new jobs, and twenty-one 503 loans, totaling $8.4 million and creating 374 new jobs.

The Kansas City Corporation for Industrial Development was established in 1978 to respond to the flight of businesses from the central city to suburban areas. The Mayor was one of the incorporating members.

Two-thirds of the corporation's funding comes from the city in the form of CDBG and general revenue sharing funds; the remainder from private sector sources. The development corporation uses SBA's 503, 502 and 7(a) programs, revolving loan programs, and CDBG loans. It also has the authority to issue industrial revenue bonds. KCCID is the major economic development organization in Kansas City, Missouri. Since its inception it has funded twelve 502 and 503 projects for $4.2 million, creating 321 new jobs.

With offices in Portsmouth City Hall, the Granite State Economic Development Corporation serves almost two-thirds of the State of New Hampshire and is a certified development company handling 503 loans exclusively. The professional staff is loaned to the corporation from city government. To date eleven projects have been approved -- with the average debenture between $225,000 and $250,000 — and more than 250 jobs have been created.

The St. Paul 503 Development Company was organized in 1982 in response to a lack of long-term, fixed rate financing for small business. The Company is staffed by professionals from St. Paul's Department of Planning and Economic Development. The Neighborhood Development Division of that Department handles SBA's 7(a) loans, commercial rehabilitation money from CDBG, and CDBG-source leveraging for the 503 program.

Part of a $200 million total economic development effort, the 503 Program has been responsible for $5.5 million in investment in 26 deals that have created 176 jobs for St. Paul. In addition SBA's 7(a) program has created 40 to 45 jobs in that city with a $1.5 million investment.

St. Paul recently set up a small business incubator using the 503 Program. Because of that incubator, 52 jobs in real start-up businesses have been created.

Unlike the cities described above, Wichita has six certified development corporations. Since fiscal year 1982 they have undertaken 57 projects which have created over 1,000 jobs. The debentures have totaled $5.9 million; the total investment in the projects has been $15.8 million. While SBA requires that one job be created or retained for every $15,000 of debenture invested, the debenture investment in Wichita has been $5,700 per job.

It is evident that the S.B.A. and its financing programs have been responsible for creating thousands of jobs within our cities today that might not have been created for several years — if ever.

Eliminating the S.B.A. now would deal a significant blow to America's small businesses. It would also have a devastating effect on the continued economic recovery and revitalization of our cities.

Currently, my office and other city offices across our country work hand-in-hand with the S.B.A. putting together successful development projects. These are not weak projects which are doomed to fail — as many people characterize S.B.A. loans. Instead, they are strong projects destined to succeed, and to create new jobs.

As an indication of the type of loans the "new" S.B.A. is making, I ask you to again look at my city -- Springfield, Illinois. Of the eight 503 loans approved since May, 1982, no loan has ever been in default. In fact, not one of our eight projects has even made a single late payment -- most banks would envy a loan portfolio that strong.

But make no mistake. Without the Small Business Administration, few, if any, of these projects could have happened. The long term, fixed rate financing offered by the S.B.A. is not otherwise available. Most financial institutions now have lending policies which specifically preclude their making long-term, fixed-rate loans. So the elimination of the S.B.A. would create a financing void which could not otherwise be filled.

I am not here today to argue that all current S.B.A. programs are good ones and should be retained. We know that is not true. However, Senate Bill 408 would save the S.B.A. programs which have been responsible for creating almost 200 jobs in my community, 2,700 jobs in the State of Illinois and 70,000 jobs across America. At the same time, it would eliminate the S.B.A. programs which have, for years, made bad loans with little chance of repayment.

I believe Senate Bill 408 represents a comprehensive solution to a comprehensive problem. It addresses the immense problem of the federal deficit while being responsive to America's small businesses.

The U.S. Conference of Mayors hopes that Congress will recognize the important partnership which has been established between America's cities and the S.B.A., and that you will work to strengthen that partnership — not eliminate it.

Thank you.

The CHAIRMAN. Thank you very much, Mayor Houston.

There is one aspect of your comments which I think deserves emphasis. When you say the new SBA, I think that is important because, starting several years back, both between the work of this committee and working hand in glove with the new Administrator, James Sanders, it is an entirely different operation now than it was before.

No. 1, this committee started to exercise an oversight function rather than having SBA as a forum for all sorts of individual projects for the Senators who sat on the committee.

By the same token, Mr. Sanders brought a businessman's approach toward the agency, not a politician's approach. Admittedly, quite frankly, in the past there were all sorts of political shenanigans and a who-got-what approval to various programs.

This is an entirely different operation today. The laws on the books—passed by this administration, by this Congress—make it an entirely different type of operation.

The one pride that I take as the chairman of this committee is that all of these reforms went on long before David Stockman advocated eliminating the SBA. Many of us have worked for years on the problems that were in the SBA, and more work still lies ahead of us.

I think what you say is true. There is absolutely no resemblance at all between the SBA as it exists today and the SBA as it existed 5 years ago.

Mr. HOUSTON. The real thrust behind the 503 program is that that program is designed to help successful businesses. There are successful small and medium-sized businesses that need that help.

Undoubtedly, the 503 program, in the 6 years that I have experienced working in economic development activities in Springfield, is the best Federal program that I have seen come down the pike, and I think it certainly not only needs to be saved; it needs to be strengthened and expanded.

Senator DIXON. Mr. Chairman, if I may put a comment on the record, my good friend, the mayor, referred to the fact that a century-old hotel in Springfield, our capital city, was remodeled under this program, and I want the record to show that I was honored to be invited by the mayor a couple of years ago when that old hotel, the Governor Hotel, was reopened with a beautiful new restaurant called the Green Turtle.

I want the chairman to know that whole neighborhood was an old, rundown neighborhood, almost a slum. It is now a beautiful section of Springfield only a few blocks from our State capitol. I used to stay sometimes in that old hotel 35 years ago when I was a freshman in the Illinois House.

It is a tribute to the mayor and his work with these programs what has been done in that neighborhood. It has been a real delight to go back there to the capital city and to see what the mayor has done in that area of that town.

Mr. HOUSTON. Thank you, Senator.

The CHAIRMAN. What this all comes down to is that if we can't find Senator Dixon on the Senate floor, we are going to find him in the Green Turtle in Springfield, IL. [Laughter.]

Mr. HOUSTON. One thing about Senator Dixon, he believes in staying in touch with his constituents and he does make an effort, whenever he is in Springfield, to stay in touch with as many of those constituents as he can. [Laughter.]

Senator DIXON. Absolutely.

The CHAIRMAN. Mayor, thank you very much.

We now have as the second member of the panel the Honorable Ralph Johnson, the mayor of Warner Robins, GA.

Mayor, it is nice to have you here.

STATEMENT OF HON. RALPH A. JOHNSON, MAYOR OF WARNER ROBINS, GA, AND PRESIDENT, DEVELOPMENT CORP. OF MIDDLE GEORGIA, ON BEHALF OF THE NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

Mr. JOHNSON. Thank you.

I don't have the credentials of my cohort from Springfield, IL. However, I have the same problems he has—a smaller number of commodes that don't flush; the water goes off; the streets need paving; and all the things that happen in municipalities.

I have been active in my city for about 18 years in getting financing for small businesses, assisting small businesses.

I started my third career by being elected mayor of my city last fall. My first career was as a military officer, 15 years as a contracting officer dealing both with small business and large business, and I am a free enterpriser to the core.

I have had 14 years as a member of the board of directors a NADO-type of organization, a planning and zoning commission in our area of about 300,000 people, of urban and rural people. Our board is made up of black, white, male, female, rich, poor, a real cross-section of our area. The NADO-type organization I belong to gave me the honor of being the first president of our Certified Development Corp., the 503 activity.

The 503 activity, in my opinion, is one of the best things that has come down the pike as far as SBA is concerned. It has eliminated many of the criticisms concerning direct loans or the guaranteed loans that we have heard in the past.

Unfortunately, in those two programs, you hear about the failures a whole lot more than you hear about the successes, and I am sure that you recognize that, too. They, too, have had their successes.

Any loan that is made that assists the small business is an asset to this country. In our area, we have small banks and we have large banks.

When you first enter the market center for money, you get very little attention from a large bank, because they have their customers. In many cases, our small banks are unable to fully finance a loan.

But with the 503 program of 50 percent, we certainly are able to have much activity than ever before. We are competing with the farmers; we are competing with other people in the small business arena.

The 503 program, through our NADO-type organization, has a board of directors made up of the same kind of cross-section that represents the NADO organization. We get the expertise free from the financial institutions at no increase to the bureaucracies, no increase to the Federal payroll. It has worked well in that way.

We find that our banking institutions are now becoming active because they recognize the advantage of the 503 loan. Through the 503 loan—I cannot give you great numbers of millions of dollars, but I can tell you that in about 1 year, 1½ years, we have placed 10 such loans, creating about 75 jobs.

In one instance, with a $1 million, we saved 24 jobs and created 9 new jobs in one activity. In the area in which I live, that has an economic impact.

If you are looking for cooperation and partnership between the private sector and the public sector, the 503 gives it to you, and it gives it to you to the grassroots.

I recommend to you the use of the NADO-type organization in the small business activities such as we have done in the 503 Program. I think it should be expanded, and I think that you should investigate the use of these local people who serve without pay, who have great expertise in many, many fields. On our board, we know the rascals and we know the angels, and it works well.

Large business may be able to produce the wheel at a lower price and in greater numbers, but the wheel was invented by a small businessman.

I am ready for any questions.

[The prepared statement of Mr. Johnson follows:]

NADO

NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS
400 North Capitol Street, N.W., Suite 372, Washington, D.C. 20001 202-624-7806

Testimony of:

RALPH A. JOHNSON, PRESIDENT

DEVELOPMENT CORPORATION OF MIDDLE GEORGIA

MAYOR, WARNER ROBINS, GEORGIA

On Behalf of The

NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

Before the

Committee on Small Business

U.S. Senate

On

The Small Business Administration

March 7, 1985

Washington, D.C.

TESTIMONY OF RALPH JOHNSON, MAYOR OF WARNER ROBINS (GEORGIA) AND PRESIDENT OF THE DEVELOPMENT CORPORATION OF MIDDLE GEORGIA ON BEHALF OF THE NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS (NADO) BEFORE THE COMMITTEE ON SMALL BUSINESS, U.S. SENATE, MARCH 7, 1985.

Mr. Chairman, members of the Senate Committee on Small Business, I am Ralph Johnson, President of the Development Corporation of Middle Georgia, a Small Business Administration (SBA) Section 503 Certified Development Company which serves a seven-county area with a population of 300,000. Last fall, I was elected Mayor of Warner Robins, after having served for 14 years as Executive Vice President of the Greater Warner Robins/Houston County Chamber of Commerce.

I am here today representing both Middle Georgia and the National Association of Development Organizations (NADO) whose members are locally-based economic development organizations like the Middle Georgia Area Planning and Development Commission. NADO members are involved in community, business, economic and rural development activities in small cities and rural areas.

The Middle Georgia Area Planning and Development Commission was responsible for organizing the Middle Georgia Development Corporation in 1982. In 1983 the Development Corporation was certified by SBA to provide 503 financing. More than half of the 541 existing Certified Development Companies were established on a regional basis by development organizations to serve small businesses in small cities and rural areas.

A few years ago it would have been highly unusual for a mayor or other local government official to be asked to testify about the value of Small Business Admininstration programs. But I am here today on behalf of the local governments and the businesses in our area which have utilized and benefitted from the innovative approaches to economic development financing that the 503 program has made possible. Although there is a great deal of talk in Washington about public-private partnerships, in Middle Georgia and many other parts of the country, we recognized the need for such partnerships and cooperation many years ago and organized locally through our Area Planning and Development Commissions to create private sector jobs for our citizens. I have served on the Advisory Board of the Middle Georgia APDC for 14 years, and I'm proud to say that Senator Nunn was also a member and Chairman of the APDC Board.

On behalf of NADO and the Middle Georgia Development Corporation, I urge this Committee to enact legislation to reauthorize the Small Business Administration for three years, and to oppose any effort to eliminate the agency or its funding.

THE IMPORTANCE OF SBA TO SMALL COMMUNITIES AND THEIR LOCAL GOVERNMENTS

The economies of small cities and their surrounding rural areas are based on small business and the tax bases of these local governments are dependent on small business. In most of the small towns and counties in our region there is virtually no business but small business.

As important as small business is to rural county and municipal governments, there is relatively little these local governments can do on their own to help indigenous small firms meet their needs for capital and credit. This is an especially serious handicap in economically underdeveloped rural areas that have limited local access to private credit markets. Many small rural banks are in financial trouble and more distant urban banks are extremely reluctant to lend to small businesses not located within their immediate areas. In our region, as in many others, the problems of the farmers are having a serious impact on our local economy. When the farmers are in trouble, our small businesses, banks and local governments are also in trouble.

SBA's section 503 Certified Development Company Program is the small business program that has been most important to Middle Georgia and to hundreds of small cities and rural areas around the country. This important financing program was made possible through the efforts of many people. This Committee and Senator Nunn, who is from Middle Georgia, were very farsighted in developing the legislation that established the program. In Middle Georgia the Area Planning and Development Commission economic development staff recognized the value of such a program in our region and provided the expertise needed to obtain certification for our development company. Without the "institutional infrastructure" provided by the APDC, small communities would not be able to establish such a program.

While I realize that this Committee is responsible only for SBA authorization, I would like to remind you that the Administration has asked for elimination of not only SBA but also the Economic Development Administration (EDA) which is the agency that has been the backbone of local economic development efforts in small cities and rural areas for nearly 20 years. Without the economic development districts such as the Middle Georgia APDC supported by EDA, large areas of this country will not have any hope of participating in the current economic recovery.

WHAT THE DEVELOPMENT CORPORATION OF MIDDLE GEORGIA HAS DONE

The SBA 503 program has brought to Middle Georgia an initial investment of $2.6 million of which over half has come from private sector sources. Thus far, 10 projects with 503 funds have created or saved 71 jobs in our communities while increasing property tax revenues, encouraging renovation of urban business facilities and improving services for citizens in both urban and rural areas. Since our 503 corporation was certified only in 1983, nine of the loans were made in 1984. Now that the program is becoming better known, we forsee an increasing demand for the funds in our region. For less urbanized areas like ours, it has been important to have a regional Certified Development Company that could process a sufficient volume of loans to eventually become self-supporting without sacrificing quality in its assistance to local businesses.

The public investment in small business development is tiny compared to tax revenues generated from the expansion of businesses and new employment. With a default rate of less than three percent nationwide and no defaults in Middle Georgia, the 503 program is an example of sound investment by both private and public sectors in economic development.

Requiring private sector participation in program activities helps ensure community support and involvement which leads to a greater percentage of business successes. I commend the program originators and the SBA for having the foresight to include this requirement. It is our experience that a bank may not be inclined to provide 80 to 90 percent of the financing for a small firm in a commercial loan situation. But it is more likely to provide 50 percent of the financing in a 503 project. Take away the SBA participation and you take away opportunities for small business development and expansion.

Our objective at the Development Corporation of Middle Georgia is to stimulate growth and expansion of small business and create new jobs. We have been able to accomplish this through SBA programs such as 503. I am proud to be associated with a program that generates jobs for our citizens and develops our community resources.

I would like those who are trying to abolish SBA to listen to four business people who are participating in the 503 program. This is what they have to say:

> WILLIAM GRANT: "I would not have been able to make an investment in this building and remodel it without assistance from the SBA 503 program. This made it possible to hire two new employees and increase sales."
>
> H.C. SMITH: "Without 503 assistance, it would have been impossible to put a project together and save a business from closing which employed 24 local people. This program has allowed us to increase production capacity and employment."
>
> JERRY BRIDGES: "We tried every way possible to locate financing to begin our business. We had the market information which indicated the venture would be successful, and the 503 program made the project possible."
>
> H.R. BECK: "Without this program, we would not be in business."

These individuals represent a cross-section of the small business people in our region. Mr. Smith's company, Allegheny Rubber, is the recipient of our largest loan which financed the buyout of a rubber treading company that was going to close in the City of Macon. By obtaining a loan of $1.1 million, 24 jobs were saved and nine new ones created. Mr. Grant is a minority businessman who was able to buy a building in an area of Macon which is being revitalized and expand his bakery and employment. The jobs created and saved are important to the people who have them and to the communities where they reside.

SMALL TOWN AND RURAL ECONOMIC DEVELOPMENT NEEDS

The general economic recovery of the past two years has by-passed many rural areas. The unemployment rate in Middle Georgia is still above the national average, as it is in many rural areas. According to the U.S. Department of Agriculture, the nonmetropolitan unemployment rate exceeded the metropolitan rate by two percentage points in 1982. In 1983 the nonmetropolitan median family income was only $20,983 compared to $26,488 (27 percent higher) in metropolitan areas.

The nonmetropolitan economy has failed to perform as well as the metropolitan economy during the 1980's. Not only have there been problems in the agricultural sector, but also many of the manufacturing businesses in rural areas are mature, slow-growth industries that tend to relocate to low-wage locations in Third World countries.

The financial problems of many farmers and the consequent liquidity problems of small, rural banks have been given significant publicity lately. Clearly, many of those troubled financial institutions are in no position to provide adequate credit on affordable terms to local non-farm businesses. The Reagan Administration's strategy for rural development recognized this problem:

> In rural areas, financial institutions are significantly smaller in terms of asset size. Consequently, the range of financial and financially-related services is not as broad in rural areas for meeting community development needs as in large metropolitan areas (e.g., correspondent services many not be available).

The SBA 503 program and others help provide credit which would not otherwise be available to small businesses in rural and small towns. According to a letter our development company received from President Reagan, "In recent years, new and existing small companies have provided an astonishing 80 percent of new jobs in the private sector and 24 times as much innovation as larger business." We think it is only fair that entrepreneurs in all parts of our country should continue to have access to credit and assistance which will encourage them to grow and expand.

SBA has helped thousands of businesses over the last 32 years and this has helped thousands of communities. Although the 503 program was not begun until July 1980, we believe it has been one of the most successful programs of the agency and that it has helped bring about our economic recovery. It has helped provide new jobs, enhance business ownership opportunities and stimulate local economies. It makes sense to continue those programs which have clearly benefitted our economic recovery and which hold the promise of sustaining growth and creating jobs.

CONCLUSION

The Office of Managment and Budget (OMB) has stated that the Small Business Administration programs are simply aids to certain private business firms which do not need these "subsidies." The OMB perspective is that government intervention such as those represented by SBA programs is a wasteful distortion of otherwise efficient market forces. We do not view the SBA 503 program as a subsidy or as "federal intervention" in the marketplace. We believe it is an important tool which can be used as a part of local economic development strategies in rural and small metropolitan areas like Middle Georgia.

It appears that the OMB does not understand the importance of small business to the economic base of this country, despite all the studies that show how vital it is. The need for small business expansion and development is more important than ever, and we think programs such as SBA and the Economic Development Administration are vital to the economic well-being of thousands of communities across the country.

I am proud to be associated with a program that generates jobs for our citizens in the private sector, and I think it should be continued. Certainly, there are improvements which can be made in any program to make it more efficient. For example, NADO members believe that there should be money available for funding development districts organizations to provide management assistance to small businesses. We know that many small businesses fail because of inadequate management and that most of those failures could be avoided. However, many small firms are remote from sources of assistance and cannot afford to import management experts from the big city. Under a contract with SBA's Office of Management Assistance, NADO is currently field testing the use of circuit riding management consultants to solve the problems of rural businesses. Three development districts organizations are providing the institutional settings for this effort. Based on our experience, it seems wise to us to devote some federal resources to helping such firms so that they can avoid wasteful failures and contribute more to the national economic health.

Eliminating agencies such as SBA will make it impossible for many businesses to expand, create new jobs and add to the growth and stability of our national economy. Therefore, I urge this committee to work to save the Small Business Adminstration and the 503 Certified Development Company program.

Thank you for inviting me to appear before your Committee. I will be happy to answer questions.

The CHAIRMAN. Well, I thank you very much.

Let me ask you this. First of all, what size is Warner Robins, GA?

Mr. JOHNSON. About 42,000.

The CHAIRMAN. And is there an active SBA Program in all aspects down there that you know of, not just 503, but also has there been any activity in the 7(a) Guaranteed Loan Program?

Mr. JOHNSON. Yes, we have activity in that area. However, I have not been as active in that area as I have been in the 503. I have been active in what we call the Downtown Development Authority and also the Development Authority for Industrial Revenue Bonding.

I can say to you, the 503 program advantage over those two programs is that the 503 has little or no impact against the Tax Digest. The other two are tax exempt activities, and they do have an impact on the Tax Digest. So therefore, I do think that that is a great advantage in the 503 Program.

The CHAIRMAN. One of the things that you alluded to is the fact that the small banks are the ones that get involved in this program. I think that is very important to point out. I know the same holds true in my State of Connecticut.

The big banks are free to say that this really is an activity that should be handled by the medium-sized and the small banks. They don't disparage it—they think these are pretty good programs—but they don't get into them.

I worry as I see these financial institutions getting bigger and bigger and bigger. What is going to happen to the small business person and the small banks? I would hope that there would always be small banks as there are small businesses, and yet everything that I see around me nowadays points to mergers. All of these companies and all these banks merging, and I don't know where it is all going to end, but I don't think it is necessarily in the best interest of the small communities around the Untied States. That I will say.

Mr. JOHNSON. Bigger is not necessarily better. It bothers me, too.

The CHAIRMAN. I don't know if Governor Johnson has left yet, but when we had the person from Cray here testifying vis-a-vis the Cray Research group out of Minneapolis—and they had difficulty getting their third tier of financing, which they finally got it through an SBIC—a significant part of the testimony was that the reason that they got financing was because the SBIC that they got that loan from was a local SBIC who knew Seymour Cray.

Very frankly, that loan was made on the basis of their knowledge of the individual, and they could not get the capital they needed from out-of-State banks or out-of-State SBIC's.

That is a key element, and I think you raised that when you discussed this rather large panel that you had. Everybody knows everybody else. Everybody knows the value of the individual. What price do you place on that? If it were a decision made by some fellow sitting up in the 50th story in New York City or in Atlanta or someplace, that fellow very well might go by the wayside.

Mr. JOHNSON. That is your best collateral in many cases, the character of the individual getting the loan.

The CHAIRMAN. Senator Kerry.

Senator KERRY. I have no questions, Mr. Chairman.

The CHAIRMAN. I thank you both very much for your testimony and for making the effort to be with us today. Thank you.

Mr. HOUSTON. Senator Weicker, thank you very much for the opportunity, and again, I did not mention, but I just summarized the statement that was provided, and I would ask that the entire statement be put into the record.

The CHAIRMAN. The statement will be included in its entirety in the record.

Mr. HOUSTON. Thank you.

The CHAIRMAN. Our second panel consists of Mr. William Thomas, chairman of the National Association of Small Business Investment Co. Mr. Thomas is also president and chairman of the Capital Southwest Venture of Dallas, TX.

Also appearing with Mr. Thomas on the panel will be Mr. Patrick Burns, American Association of Minority Enterprise Small Business Investment Co. Mr. Burns is also president of Minority Equity Capital Corp. of New York.

Also on this panel will be Mr. Martin Orr, who is president of the National Association of Development Co. Mr. Orr is, additionally, executive director of the Kansas City Corp. for Industrial Development, Kansas City, MO.

Gentlemen, it is nice to have you all with us this morning. Please proceed with your testimony, and we will have Mr. Thomas lead off.

STATEMENT OF WILLIAM R. THOMAS, PRESIDENT/CHAIRMAN OF CAPITAL SOUTHWEST VENTURE CORP., ON BEHALF OF THE NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. THOMAS. Thank you, Mr. Chairman.

My oral comments will be brief, inasmuch as we have prepared a longer written statement, which I would appreciate your entering into the hearing record.

Since Mr. Burns is here on my left to represent the American Association of Minority Enterprise Small Business Investment Co., my comments will focus on the non-MESBIC segment of the SBIC industry.

First, a personal note about the company that I manage. Capital Southwest Corp., which is a venture capital firm, has, as a wholly owned subsidiary, Capital Southwest Venture Corp. This entire operation had its beginning an SBIC in 1961.

Our company has, over this period of nearly a quarter century, invested some $76 million in total in some 120 small business concerns. I think it is fair to say that many of those concerns would not have been conceived if our company had not been there to provide the financing.

We were serving in a role that enabled these companies to obtain senior financing from banks and other investors, but in our absence—and that is true today as it was in the past—many of these firms would not have been launched, and we would have failed to see some very exciting growth businesses that were created.

During the time that our company and the companies that operate as SBIC's in this industry have existed, I have seen the industry grow and prosper and increase in sophistication. Collectively, our Nation's SBIC's have, in my judgment, proved to be one of the most effective and discriminating means of financing small businesses that have real growth potential. I know this program works, and I am appalled that its continuity is threatened.

On behalf of the National Association of Small Business Investment Companies, which I serve as chairman this year, I would like to state that that association wholeheartedly supports the passage of S. 408, and we commend you and your cosponsors for its introduction.

Preservation of SBA is NASBIC's highest legislative priority this year, and S. 408 is a positive response to the administration's completely negative proposal to kill the SBA and all of its financial assistance programs.

The 391 SBIC's located in 46 States, most of whom are members of our association, are seriously concerned about the negative impact of huge Federal deficits. We are keenly aware of how damaging high inflation and high interest rates can be to small businesses and to our companies.

At the same time, however, we think it is utterly foolish to terminate a program that has achieved such spectacular results and is a profitmaker for our Government.

For a moment, I would like to focus on the Government's return on its investment in the SBIC Program. First, let's look at the income side of the ledger.

SBIC's and the portfolio companies they invest in return to the Federal Treasury increased tax revenues far in excess of the handful of dollars the Government spends on the program.

A clear example, Mr. Chairman, was the chart that you prepared for last week's hearings that showed 10 outstanding SBIC-assisted companies that paid almost $200 million in Federal taxes in 1983. One of those companies, I am pleased to report, was Pandick Press, that had been financed by our company in its initial stages.

That tax revenue of $200 million from those 10 companies alone was more than the total SBA-guaranteed lending to the entire SBIC industry in the same year.

In addition to those 10 companies, there are thousands and thousands of other portfolio companies which are major taxpayers today because of the SBIC Program. In the absence of this program, I am convinced that a large proportion of these companies would not have been conceived.

On the expense side of the ledger, three points are worthy of mention. First, when SBIC's borrow through the Federal financing bank, they pay more than the cost of money to the Treasury. There is no subsidy involved.

Second, the user fees which are now paid by SBIC's more that cover the SBA's cost of operating this program. Finally, new tax revenues generated by the SBIC Program have covered the Government's losses hundreds of times over.

With respect to losses on the SBIC Program, SBA losses are very low, in large part because the SBIC's private capital is at risk first.

Before Uncle Sam loses 1 dime, there is a total loss of the private capital of any SBIC which may fail.

During the first 25 years of the program, SBA has written off only $38 million. Thus, the average loss rates on its loans to the SBIC industry are less than one-half of 1 percent a year.

It is my belief that this loss experience will diminish in future years because we have an increasingly sophisticated management in this industry; we have more adequately capitalized companies; and there has been a substantial maturing of the industry over this past quarter century.

Mr. Chairman, 2 weeks ago, a single SBIC portfolio company, Cray Research, testified that they paid in Federal income taxes in just a few years more than twice the $38 million lost by SBA on the SBIC Program over 25 years.

This program has also been a tremendously successful and efficient vehicle to stimulate job creation. Economic studies have shown that a new permanent job is created for each one-time SBIC investment of $6,500. Therefore, at the current level of investment that the industry is experiencing, SBIC's are creating an estimated 65,000 new jobs each year.

The Government's gross expenditure for each of these new jobs is a meager $150. This is reduced to zero, and in fact generates a large profit, when you consider new tax revenues the program generates.

The chart that was shown on the 10 SBIC's that were featured in the previous testimony shows graphically how SBIC's impact job creation. This chart showed that those 10 SBIC-assisted firms had employment that rose from 1,604 to an amazing 53,172 employees.

One additional observation I would like to make regarding the program: Mr. Stockman suggested last week that the SBIC program is no longer necessary because a large private venture capital industry now exists. That industry, incidentally, was spawned from the early experience of the SBIC's.

That conclusion is dead wrong because it is based on a very superficial understanding, or lack of understanding, of what the venture capital industry is all about.

SBIC's account for over 20 percent of the venture capital industry's resources, and loss of that $2 billion in capital, over $1 billion of which is private capital, would be an enormous blow to small business.

Even though it has grown substantially, the entire venture capital industry simply cannot finance all the growth capital needs of qualified small firms. The spirit of entrepreneurship in America has produced a tremendous demand for capital which we envision continuing for many years to come.

Most private venture capital firms concentrate in high-tech investments with prospects for extremely rapid growth. While SBIC's are also active investors in technology-based companies, they invest in a far wider and more diverse range of businesses, including many traditional or more mundane industries.

In that connection, I would like to cite a portfolio company that was one of the companies that was honored by SBA and President Reagan with about a dozen SBIC and MESBIC portfolio companies a couple of years ago. This was Palm Harbor Homes of Dallas, one of the businesses that we supported at its inception.

The company was a startup when we invested in 1977. We supplied a majority of the capitalization of this company. It had initial equity capitalization of less than $1 million. Our firm invested $500,000 at that time.

Today, the company employs 943 people; it has annual sales of approximately $100 million; it is very profitable. Moreover, this company was innovative. It developed an energy-efficient manufactured housing unit that advanced the industry in that respect and really has contributed to the general acceptance by the manufactured housing industry of energy-efficient type construction.

If you calculate back and look at the result of the $1 million in capitalization that that company received, the invested capital per job created was approximately $1,000.

Because of their far wider geographical dispersion, in some 46 States, SBIC's reach into many nooks and crannies of the country that are untouched by the venture capital industry, which tends to be concentrated in the high-tech areas.

Finally, it should be noted that the non-SBIC segment of the venture industry has a highly cyclical history. In the face of that condition, it is entirely possible that circumstances may change.

The recent flow of funds into the private venture industry has come from pension trusts and other institutional investors whose investment tastes change. Their interest in venture capital has in fact cooled substantially during the past year.

In conclusion, Mr. Chairman, our industry applauds you and this committee for their efforts to continue the SBA and its proven programs. Even though the proposed authorization levels under S. 408 represent a freeze which will prevent the SBIC industry from producing at its maximum capacity, we understand the budgetary constraints you face.

We will continue our efforts to design an improved private sector format for the SBIC program. We hope your committee will give serious consideration to the proposed Corporation for Small Business Investment in this session of the 99th Congress.

On behalf of the National Association of Small Business Investment Companies, I want to thank you very much for the opportunity to provide our statement.

[The prepared statement of Mr. Thomas follows:]

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Statement Of

WILLIAM R. THOMAS

Before the

SENATE SMALL BUSINESS COMMITTEE

March 7, 1985

TO THE MEMBERS OF THE COMMITTEE:

On behalf of the officers and members of the National Association of Small Business Investment Companies, I wholeheartedly support the passage of S. 408, legislation authorizing appropriations for the Small Business Administration.

I am William R. Thomas, Chairman of NASBIC, and also President and Chairman of Capital Southwest Venture Corporation, Dallas, an SBIC which was licensed in July 1961. Our SBIC has $4.6-million in private capital and also has invested the $6-million it has borrowed from the SBA. During the past 24 years, Capital Southwest has invested over $76-million in some 120 small business concerns.

Our Association represents the overwhelming majority of all licensed SBICs and MESBICs and has testified often before your Committee in the more than 26 years since it was organized in 1958. Since the American Association of MESBICs will also present testimony to your Committee, my statement will focus on the non-MESBIC segment of the industry. We are grateful once again to you for giving us this opportunity to present our views on this most important piece of legislation.

We commend the nine members of your Committee who have joined in sponsoring S. 408; we hope that the hearings will convince the entire membership to report the measure to the Senate favorably with a unanimous vote. In ordinary times, this three-year authorization legislation would be critically important to our industry, since it provides the guidelines on the ability of SBA to provide loans to fully-invested SBICs and MESBICs. Our efforts have been somewhat hampered over the past several years when no one was certain how many dollars, if any, SBA would have to lend to the industry.

Today, however, the legislation before you is immeasurably more significant, because it stands in stark contrast to the Administration's proposal to kill SBA and all its financial assistance programs. Several weeks ago, NASBIC's Executive Committee made the preservation of SBA its highest legislative priority, so we make this statement in favor of S. 408 with no reservation. It is a positive response to a completely negative proposal.

NASBIC members are no more complacent about huge Federal deficits than other informed citizens. Along with our portfolio companies, we have struggled through periods of high inflation, high interest rates, and credit crunches. We know those harmful events often result from fiscal irresponsibility -- and we fear the impact of present and prospective deficits on the small firms we have invested in.

On the other hand, neither we nor our portfolio companies would kill the profitable segment of our business, just because the unprofitable elements of the business pushed the entire operation into the red. And I can tell this Committee without equivocation that the SBIC program is a profit-maker for Uncle Sam. Surveys undertaken by the Government itself, as well as studies conducted by Arthur D. Little, Inc. and Deloitte, Haskins & Sells, have demonstrated beyond question that SBICs and their portfolio companies return to the Federal Treasury in increased tax revenues far more than the handful of dollars expended by the Government.

I have seen the chart you prepared last week for these hearings, Mr. Chairman, concerning the taxes paid by 10 outstanding businesses which received venture capital from one or more SBICs. These 10 companies paid almost $199-million in Federal corporate taxes in just one year. Think of it!! Only 10 of the small businesses we assisted at start-up or at a crucial stage of their development paid more in taxes in 1983 than the entire SBIC industry drew down in loans from SBA. Obviously, these 10 represent some of our most dramatic "winners", but I can tell you that there are thousands of other portfolio companies which are major taxpayers today only because they received dollars and management counsel from an SBIC.

There's no subsidy in the SBIC program!! When SBICs borrow from the Federal Financing Bank, through an SBA guaranty, they pay more than the cost of money to the Treasury. For the past seventeen months, operating SBICs and those applying for licenses have paid sufficient fees to cover most of the costs of operating the investment arm of SBA, and for the past two months, SBICs have paid a "user fee" when they borrow. We estimate that this new user fee will bring in more than $2-million each year. Thus, just by paying these fees, SBICs offset all the costs of the program, without taking into consideration taxes paid by SBICs themselves, their partners or shareholders, and the increased taxes paid by SBIC portfolio companies and their employees.

The SBIC program has proven to be an exceedingly low-risk undertaking for the Government. In spite of the fact that most SBICs are venture investors and we find that losses are inevitable in our business, the industry's record since 1958 clearly confirms that, on a composite basis, the performance of the entire portfolio of all SBICs overcomes such losses by a substantial margin. I am sure I need not remind you that each SBIC bears 100% of each loss it sustains and SBA loses only after the entire capital of the SBIC is wiped out. This is the genius of the program -- private dollars are at risk. I can tell you from personal experience that my company is a poor loser; we do everything possible to turn around bad situations. Even then we sometimes have to bite the bullet and concede that we've made a bad investment and write off those dollars against gains realized on other investments or against our private capital.

At NASBIC's Annual Meeting last November, an official of the Investment Division of SBA stated that SBA had written off only $38-million in loans to SBICs during the first 25 years of the program. That's an average of $1.5-million a year. We estimate that the average outstanding leverage during that 25 year period has exceeded $500-million, so you can see that SBA's average loss on its portfolio is less than one-half of one percent a year. On February 21, John Carlson of Cray Research told your Committee that his company owed its existence to the work of an SBIC; he also said that Cray Research has already paid a total of $83-million in Federal corporate taxes in the few years since it became profitable. Think of it: Uncle Sam has lost a total of $38-million on its loans to all SBICs, but has received more than twice that amount in taxes from just one company.

I'd also like to point out that the SBIC industry is extremely proud of its role in job creation through investments in small growth firms. One of the most important conclusions from the Deloitte, Haskins & Sells economic impact study was that a new, permanent job is created for each one-time SBIC investment of $6,500. The SBIC industry is currently investing funds in emerging growth companies at the record annual rate of $425-million. Based on the Deloitte analysis, this means that the industry's investments are creating over 65,000 new jobs a year.

Remember, too, that this is being done at absolutely no cost to the government. The other striking conclusion of the Deloitte study was that the Federal Government spent only $312 in direct outlay to create a new job through the SBIC program. When we take into account the new fees levied on SBICs to offset program costs, the Government now spends at most $150 to create that new job. When tax revenues generated by the program are considered, the Federal Government comes out a major winner in terms of tax income, as well as in creating new employment.

Let's put some flesh on those bare-bone statistics. Your Committee has already heard from Cray Research and Pandick Press. The former went from 12 employees to 1,551 in the 11 years after it received SBIC dollars; Pandick Press jumped from 150 to 1,500. The chart you prepared showing the record of 10 SBIC-assisted firms showed total employment rising from 1,604 at time of SBIC financing to an amazing 53,172. It's easy to see why SBIC managers take such pride in their industry.

Let me mention one additional benefit the SBIC program provides. For the last several years, SBICs have invested more of their own private dollars than the SBA has made available in leverage. In calendar 1984, for example, SBA provided only $175.2-million in loans to SBICs, while the industry was investing a total of $425.5-million in almost 2,000 small business concerns. I would say that record proves that the Federal Government itself gets good leverage from the SBIC program.

Before leaving this section of my statement, I want to say that our industry takes serious issue with those officials and those reporters who scoff at SBA's clientele. Speaking solely for the SBIC part of SBA, I can tell you we take tremendous pride in the entrepreneurs we have backed, the dreams we have brought into reality, the jobs we have created, the innovations we have financed. I wish that you had the time to examine the tens of thousands of small businesses we have supported -- at birth, at a crucial period of expansion, or during a crisis when the survival of the business was at stake. The roster of SBIC-backed companies is an honor roll exemplifying dynamic capitalism at its best. Cray Research, National Car Rental, Intel, Federal Express, Apple Computer, Pandick Press, Teledyne, Berkey Photo, Memorex, Midway Airlines, Amdahl, NBI, Digital Switch, Dataproducts, Atlantic Research -- those are just a few of the better known. Their products and services have spurred productivity and innovation, increased competition, expanded export markets, and created new permanent jobs.

And it's not just the glamorous and "high-tech" investments we respect. In my own portfolio are dozens of firms in industries we might call "traditional". Just a little over a year ago, SBA and President Reagan honored a dozen SBIC and MESBIC portfolio companies. Among them was Palm Harbor Homes of Dallas, one of the businesses my SBIC supported with dollars and management assistance. It was a start-up when we invested in 1977; it now employs 943 people and has annual sales of approximately $100-million and is very profitable. That's great for the employees and owners of the business and for my shareholders, but it's just as good for the thousands of families who have purchased low-cost, high-quality manufactured housing from Palm Harbor Homes.

This is probably a good time to point out that SBICs are not duplicating any private sector activity. Entrepreneurs come to us because they can't get the capital and the management assistance anywhere else. They can't get bank loans; they can't raise money through a public offering; they have exhausted their own personal resources and probably the dollars of their families and friends. America's support for its entrepreneurs and its venture capital industry are envied throughout the world and the SBIC industry is a crucial part of the picture. Few of the 66,000 firms the SBIC industry has helped would have been born, would have grown, or would have created jobs if the SBIC program had not been established. Major corporations would go on borrowing from institutional lenders and raising capital through public offerings, but there's generally no room in those inns for the entrepreneur. When they receive SBIC financing, our portfolio companies don't have AAA credit ratings; they can't go public. Their ideas for new products and new services are often ridiculed by the established "experts" in the field. No public employee would have dared give financing or a contract to Cray Research; Control Data and IBM shunned the super-computer field, but an SBIC backed Mr. Cray and the rest is history.

My own SBIC and several others backed the new management of an old-line financial printing firm, Pandick Press, which applied innovative data processing techniques to an old need and led an entire industry into the new technology age. Certainly a rather "mundane" endeavor, but one which resulted in fantastic productivity gains. I thank you for giving Ed Green of Pandick Press an opportunity to testify last week; I am sure you found his story a persuasive response to David Stockman's allegations.

Incidentally, Mr. Stockman implied in his statement last week that we do not need SBICs now that a large venture capital industry exists. I reject that conclusion for five reasons. (1) SBICs still account for more than 20% of the resources of the total venture capital universe and the loss of the more than $2-billion committed to SBICs would be an enormous blow to U.S. small businesses. (2) In common with every other SBIC and venture capital manager, I know that the entire venture capital industry cannot finance all the qualified investment opportunities we see -- it's not a case of "too many dollars chasing too few good deals". (3) Most SBICs invest in situations which are not feasible for other venture capital firms. By using leverage, SBICs can make an acceptable return on their invested capital by providing funding to entrepreneurs in traditional industries. For that reason, SBICs are able to assist a much wider range of businesses than the firms in other segments of the venture capital industry. Pandick Press and Palm Harbor Homes are merely two specific examples from my own portfolio. (4) The SBIC industry has a far greater geographical dispersion than the rest of the industry; there are licensees in 46 States. Small business benefits from this broad distribution of SBICs. (5) The highly cyclical nature of the non-SBIC segment of the venture capital industry could mean that no venture capital dollars would be available if there were no SBICs. Mr. Carlson of Cray Research told you that his company was able to raise money only from an SBIC, because there were almost no active venture capital firms in 1975. Cray was not the only firm facing that situation in the mid-70s; SBICs constituted almost the only game in town during those five or six years. The same situation prevailed from 1963 to 1968 when almost every venture capital dollar invested came from SBICs. I believe we may face that condition again in the coming years, so it would be folly to wipe out the SBIC industry.

I challenge anyone to tell me that SBICs are an "un-American" aberration in our free enterprise economic system!! The private sector and SBA have joined in this unique partnership program; we've put up the capital and the management skills -- and the risk of loss -- while the Federal Government has provided some important incentives to encourage the expansion of our activities.

S. 408

As I said at the outset of my statement, I applaud the sponsors of S. 408 for taking the lead in guaranteeing the continuation of the Small Business Administration and most of its proven programs. I am not an expert on anything but the SBIC part of SBA, so my specific comments are confined to that part of the legislation.

Quite frankly, the authorization ceilings in S. 408 are likely to restrict quite severely the ability of SBICs to channel equity capital and long-term credit to small business. During fiscal 1985, SBA is operating under a $265-million ceiling on SBIC leverage and I am afraid that won't be enough to meet the legitimate needs of the industry. S. 408 calls for a ceiling of $250-million in fiscal 1986; $261-million in fiscal 1987; and $272-million in fiscal 1988. It is quite apparent that the growth of our industry will be restricted by those limitations and SBA will be forced to devise formulas for allocating the limited number of dollars.

However, we understand the environment in which you are operating, so we shall not argue for increased authorizations at this time. We still believe a steady flow of capital to SBICs provides a golden investment in economic growth and production of tax revenues, so we will continue our efforts to design a better alternative format for the SBIC program. I hope we will be able to testify before your Committee on the proposed Corporation for Small Business Investment later in this session of the 99th Congress. In the meantime, however, we strongly support S. 408 and pledge that SBICs and their portfolio companies will work with you in passing the measure.

Thank you for allowing NASBIC to present this statement.

The **Chairman**. Mr. Thomas, thank you very much.

I am going to move to the other witnesses, and then we will come back for questions.

The next witness is Mr. Patrick Burns, chairman of the American Association of Minority Enterprise Small Business Investment Companies.

Senator **Kerry**. Mr. Chairman, before he begins, I wonder if I might just interject.

The **Chairman**. Yes, indeed; Senator Kerry.

Senator **Kerry**. Unfortunately, as you know, I only just this week found out that I would be joining this committee, and as a consequence, I have a prior engagement which I have to go to.

I just wanted to take a moment, if I could, to welcome Mr. Frank Doyle from the Small Business Service Bureau, from Worcester, and also Lew Shattuck from Waltham, from the Small Business Association of New England, and thank them for taking the time to come down here and add their experience and important voices to this dialog.

Mr. Chairman, I apologize for not being able to stay through it. Thank you.

The **Chairman**. I think that, No. 1, we look forward to Senator Kerry's participation on the committee. Even though there are those that try to bring about the demise of the Small Business Administration, the recent appointments by both the Democratic and Republican parties assure the fact that this is going to be a very lively committee, because, indeed, as the Democrats have appointed Senator Kerry to the committee, the Republicans have appointed Senator Goldwater to the committee.

I would say that this will assure us of some very good discussions in the sense of the role of the Small Business Administration, and, indeed, the small business community. [Laughter.]

So I think it is a wonderful thing, John, that you are on the committee, and I look forward to having your deliberations. I might add, I also know your friends from Massachusetts well. There are some of those who have put a great deal of thought and effort over the years into trying to always make our small business program's better.

Senator **Kerry**. Thank you, Mr. Chairman. I appreciate it.

Thank you, Mr. Burns. I apologize to you.

Mr. **Burns**. Thank you, sir. I am sorry that you will not be able to stay.

STATEMENT OF PATRICK OWEN BURNS, CHAIRMAN, AMERICAN ASSOCIATION OF MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANIES

Mr. **Burns**. Mr. Chairman and Senator Kerry, I appreciate the opportunity to appear before the committee to discuss Senate bill S. 408 and to endorse, on behalf of the American Association of Minority Enterpise Small Business Investment Companies, that bill once again.

We appeared before staff members of this committee about a month or so ago and told them that, as with NASBIC, our top priority this year is also—flatly and without reservation—the preservation of the Small Business Administration as an essential ingredient in the mix of tools and support systems on behalf both of minority small business across the country and also of small business in a broader sense. So we strongly endorse S. 408.

I have prepared and submitted a formal statement which I will not read but will simply highlight. I would like to point out before making some comments that we had one typographical error that I would call to your attention and advise that we will send a corrected copy.

In our efforts to overwhelm the bad guys by showing the impact of small business on governmental collections, we managed to produce a table that showed that the various government bodies collected, in terms of taxation, more revenues than the small businesses themselves took in. [Laughter.]

That is an optimistic projection; it happens to be incorrect. We dropped out a 3, and on the financing table of 1984, revenues for our small business universe should have been $883 million. We actually stated it as $88 million.

The CHAIRMAN. What you are saying to me is, your figures are as accurate as David Stockman's figures. [Laughter.]

Mr. BURNS. Before I came down here, I said to my wife, would I get into trouble if I said, in a general sense, reading some of the old testimony, the old story about figures don't lie but can figure, and my wife said that I probably shouldn't say that, so I won't. [Laughter.]

It seems to the American Association of MESBIC's, in reviewing some of the previous testimony, and being aware of what this committee has heard, that you have heard from successful entrepreneurs supported by both the SBIC and MESBIC programs; you have heard from SBA, whose leadership, I think, has been placed on the horns of a political dilemma; and you have heard from Mr. Stockman, who I think presented the committee with a variety of magnificently constructed and essentially inaccurate straw horses.

I think the committee itself is aware of the nature of some of those straw horses, and I am not going to belabor the point, but in my comments I would like to highlight one or two areas where I think the presentation is charitably disingenuous.

The basic premise is that there is in fact a level playing field upon which small and large business can gambol about in freedom and equal access to a variety of resources.

Speaking on behalf of the 140 minority enterprise small business investment companies, our experience since 1971 would say flatly, "That ain't so." And those that assert that it is so are either unaware of the real world or are aware of it and would choose to deny it.

The SBA programs—not just the MESBIC programs and not just the SBIC programs but a variety of SBA programs—focus their activities on precise areas of business development, those areas most in need of resource enhancement, if one can use that phrase, and to cover the universe with gross figures and to say, "Since we can establish a pound of statistics, therefore, there is no need," I think, is a high school debating tactic that, when you become experienced as a senior in high school, you no longer use with any efficacy, because it is clearly demonstrable that there are clumps of economic activity, regions of small business development, both geographic and industrial, that would not have a chance in the free enterprise system without the focused Small Business Administration programs.

I have written down in my notes that the SBA programs are necessary for factors of ownership. It happens that the minority enterprise small business investment companies clearly, enthusiastically, and every day focus on the unique problems of minority and women entrepreneurs having ownership of economic resources.

I have written down "focus on location." A pound of statistics doesn't tell the difficulty of finding financing for an inner city business, be it a retail business—much maligned in Mr. Stockman's discussion—be it a small hardware store in Bedford-Stuyvesant, in Huff or Watts or in any of the inner cities in any of our great cities.

Those resources are generally not available on this, quote, level playing field. The commercial bank does not make those loans. The commercial bank, if encouraged to make the loans, will make them only with support and credit assistance. It will make an independent determination, but without the support of, in effect, a collateral cosigner, it will not make that loan.

Now, if I go to the bank or I open a small hardware store and I can get Uncle Harry to sign for a $50,000 loan, what does the bank care? If I am a minority entrepreneur, I don't have an Uncle Harry—that is a hard fact—and so I don't have the opportunity to use third-party collateral.

The Government policy, in this instance, is intelligently using governmental resources to create that third-party collateral to expand the free enterprise system to all small businesses.

The third area we have just referred to. It is availability of resources, the private sector, the skewing of resources at the moment away from availability to minority entrepreneurs, women entrepreneurs, and small business people in general, and a further skewing based on geography.

Thus far, the statistics and reports and discussions of many of the small business programs have focused on disappointments, unsuccessful investments. In the investment arena, if you make an investment that goes sour, you can either call it a bad investment or you can call it an unsuccessful investment, recognizing that there has been a risk assumption intelligently applied, and not in every case will that risk assumption lead to a positive economic result.

Nevertheless, as we have demonstrated in our submitted statistics, as NASBIC has demonstrated in its submitted statistics, and by anecdote, there are innumerable success stories.

The MESBIC Association, in preparing its testimony, includes in the dialog with this committee a diversity of success stories, and we have been quite deliberate about it, frankly. We have tried to find in our catalog of thousands of businesses that we have assisted since 1977, the millions and millions [illegible] financing that our companies have provided, usually on a subordinated debt basis, usually when no one else will provide patient capital—as a side note, I made a note to myself that if somebody comes to us and we believe in fact could get access to normal capital sources, we generally send them there, because that is, in our judgment, the way the system should work. If you have the ability to go to your friendly neighborhood bank and obtain financing, and you have the resources to secure that financing, we encourage that that be done.

I can assure you, Senator, and members of the committee, that there are few, if any, entrepreneurs who appear before Minority Equity Capital Co., or other MESBIC's seeking financing who have any access at all to other sources of capital. We become the first source; we become the foundation source; we become the development source.

To eliminate the SBA programs and the interaction of these programs would be to rob a whole category of minority and small entrepreneurs of access to capital.

We have cited, not surprisingly, in our testimony a successful venture in Connecticut called PKS Communications, which happened to be a MESBIC-supported and publicly traded, now, issue, one of the first in the MESBIC program that in fact has reached out into the public market.

You heard from Essence magazine last week, a success story in which MECO takes a reasonable degree of pride, having worked with the magazine over a long period of time and supporting it through very serious financial difficulties into great success.

Canal Plastic, a Hispanic-owned business in New York, is located in the Lower East Side and employs from the Lower East Side.

In Minnesota, a group of MESBIC's participated in creating a UHF TV station. There are lots of TV stations. There are not very many minority-owned TV stations.

In Michigan, the General Motors-funded MESBIC has worked with industrial coating plastics companies and a tool and die manufacturer. The diversity here is that the tool and die manufacturer was created by two Cuban-refugee entrepreneurs and nurtured through very difficult times, when no one else was there or prepared to even listen.

In Montana, the Black Feet Indian Tribe has the support of the MESBIC industry for a vitally important manufacturing facility on the reservation. I don't even think there is a bank in Browning, MT. I may be wrong. But there is no resource that was prepared to assume the risk financing of this project except the MESBIC industry, the SBA-support private-public sector MESBIC industry.

In California, X-Ten Corp., a Chinese-owned business, has expanded and developed a chassis for piggyback trailers, an innovative low-tech/tech project.

In Wisconsin, MESBIC's have financed the only minority-owned bank in the State, an important financial resource for its community. In Seattle, there is a black-owned cable TV company.

These are sort of redundant and repetitive stories of independent businesses that could not find financing except through the special programs; in our case in particular, because we are most familiar with these companies, the support of the MESBIC program.

We believe that the committee's dedication to small business and to the SBA programs in support of small business is warranted economically. We have submitted figures that show the jobs created—in our instance, in excess of 75,000 since we started computing records—created or sustained. The financial impact of our companies and the tax impact of our companies are presented in our testimony.

Thank you, sir.

[The prepared statement of Mr. Burns follows:]

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TESTIMONY

BY

PATRICK OWEN BURNS, CHAIRMAN

OF THE

AMERICAN ASSOCIATION OF MESBICS

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

THURSDAY, MARCH 7, 1985

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The Neighborhood Fund, Inc
Chicago, Illinois

Secretary
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Fulcrum Venture Capital Corp
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Capital Corp
New York, New York

RICHARD ROTHFELD
MESBIC Financial Corp. of Houston
Houston, Texas

RUBEN M. SAENZ
MESBIC of San Antonio
San Antonio, Texas

JAMES S. YU
Intercontinental Capital
Funding Corp
New York, New York

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE SENATE SMALL BUSINESS COMMITTEE. I AM PATRICK OWEN BURNS, AND I APPEAR BEFORE YOU TODAY IN MY CAPACITY AS CHAIRMAN OF THE AMERICAN ASSOCIATION OF MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANIES (AAMESBIC).

THE AMERICAN ASSOCIATION OF MESBICs SUPPORTS THE SUBJECT OF TODAY'S HEARINGS, S.408, LEGISLATION ESTABLISHING THE FISCAL YEAR 1986 FUNDING LEVELS FOR SBA PROGRAMS. THE MAJORITY OF MY TESTIMONY, HOWEVER, WILL ADDRESS THE LARGER ISSUE OF THE PROPOSAL TO ELIMINATE THE SMALL BUSINESS ADMINISTRATION. IN HIS TESTIMONY BEFORE THIS COMMITTEE LAST WEEK, OFFICE OF MANAGEMENT AND BUDGET DIRECTOR DAVID A. STOCKMAN MADE SEVERAL ALLEGATIONS CONCERNING THE SBA THAT WERE PATENTLY FALSE AND WHICH I INTEND TO REFUTE IN MY STATEMENT TODAY.

IN HIS TESTIMONY, MR. STOCKMAN CLAIMED THAT, "... NEITHER STATED SBA POLICIES NOR EMPIRICAL ANALYSIS OF SBA'S LENDING PATTERNS PROVIDE ANY EVIDENCE THAT SUBSIDIZED SBA CREDIT ASSISTANCE SERVES ANY FOCUSED OR RIGOROUSLY DEFINED PUBLIC POLICY PURPOSE AT ALL." HE WENT ON TO ASSERT THAT THE SBA IS PROVIDING FUNDS TO SMALL BUSINESSES THAT COULD OBTAIN CREDIT FROM PRIVATE LENDING INSTITUTIONS AT A

SLIGHTLY HIGHER RISK PREMIUM AND THUS "REALLOCATES FUNDS AWAY FROM MORE CREDIT-WORTHY FIRMS TO LESS CREDIT-WORTHY FIRMS...IT REDUCES MARKETPLACE EFFICIENCY AND NATIONAL INVESTMENT, JOB CREATION AND ECONOMIC GROWTH BY SUBSTITUTING POLITICAL AND BUREAUCRATIC JUDGMENTS OF PROFITABILITY AND RISK FOR MARKET JUDGMENTS.

FIRST, I WOULD LIKE TO POINT OUT THAT, CONTRARY TO MR. STOCKMAN'S STATEMENT, THE MESBIC PROGRAM SERVES A VERY WELL-DOCUMENTED PUBLIC POLICY OBJECTIVE. MESBICS ARE MANDATED TO INVEST "SOLELY IN SMALL BUSINESS CONCERNS WHICH WILL CONTRIBUTE TO A WELL BALANCED NATIONAL ECONOMY BY FACILITATING OWNERSHIP IN SUCH CONCERNS BY PERSONS WHOSE PARTICIPATION IN THE FREE ENTERPRISE SYSTEM IS HAMPERED BECAUSE OF SOCIAL OR ECONOMIC DISADVANTAGES." AS MR. STOCKMAN HIMSELF ADMITTED IN HIS TESTIMONY, IN SOME CASES PUBLIC INTEREST AND SOCIAL POLICY GAINS OUTWEIGH THE IMPORTANCE OF PURE MARKET EFFICIENCY.

IN ANSWER TO MR. STOCKMAN'S CLAIM THAT SBA MONEY GOES TO LESS CREDIT-WORTHY FIRMS THAT COULD NEVERTHELESS OBTAIN FUNDS FROM OTHER SOURCES, THEREBY DRAWING FUNDS AWAY FROM MORE CREDIT-WORTHY FIRMS, I WOULD LIKE TO MAKE THE FOLLOWING

POINT: THE PUBLIC/PRIVATE SECTOR NATURE OF THE MESBIC PROGRAM INSURES THAT INVESTMENTS ARE MADE BASED ON SOUND BUSINESS CRITERIA. THE CONGRESS, IN DESIGNING THIS PROGRAM, USED AS ITS MODEL THE SMALL BUSINESS INVESTMENT COMPANY INDUSTRY, WHICH STRESSED THE NEED FOR PRIVATE INVESTORS TO INVEST PRIVATE CAPITAL AND PRIVATE SECTOR MANAGEMENT, AND BE WILLING TO PLACE THEIR OWN CAPITAL AT RISK BEFORE THE GOVERNMENT ASSUMES ANY LIABILITY. IMPLICIT IN THE STRUCTURE OF THIS INDUSTRY IS SUCCESS. THE EQUATION IS SIMPLE: THE SUCCESS OF THE BUSINESSES THAT RECEIVE OUR FINANCING MEANS SUCCESS FOR OUR INVESTMENT COMPANIES.

IN HEARINGS ON THE MESBIC PROGRAM BEFORE THE HOUSE COMMITTEE ON BANKING AND CURRENCY IN 1972, CONGRESSMAN HARRY S. REUSS, A RANKING MEMBER OF THE FULL COMMITTEE STATED THAT "CONGRESS FULLY INTENDS THAT MESBICs BE OPERATED ON THE MOST BUSINESSLIKE BASIS"; THAT "YOU DON'T WANT SBA TO GIVE A CHARTER TO A MESBIC UNLESS SBA IS ASSURED THAT IT WILL BE SO OPERATED." AS EVIDENCE OF THIS POLICY, THE MESBIC INDUSTRY HAS A LOSS RATIO OF 1%, SIMILAR TO THE RATE FOR PRIVATE LENDING INSTITUTIONS.

In answer to Mr. Stockman's claim that SBA programs reduce marketplace efficiency, job creation and economic growth, I need only present our impressive industry statistics. Since 1976, the MESBIC industry has invested over $391 million in 4,772 small business concerns. MESBIC investments since 1977 have helped to create or maintain over 75,000 jobs. More importantly in terms of the budget, MESBIC investments since 1978 have generated federal and state tax revenues of approximately $487 million. When combined with the unemployment wages saved through MESBIC job generation, the total benefit over the seven year period is approximately $886 million. In looking at the annual cost to the government of administering the MESBIC program, the excess government revenue over costs is well over $150 million. I have attached these and other figures to my testimony.

Most importantly, the MESBIC industry has opened new business opportunities -- and even new market opportunities -- to the minority small business community. In his testimony, Mr. Stockman claimed that the SBA has failed to support the high tech, job-generating industries on the

"CUTTING EDGE" OF THE AMERICAN ECONOMY. AS CHAIRMAN WEICKER SO APTLY POINTED OUT, HOWEVER, MR. STOCKMAN WAS BASING HIS CLAIM ON INFORMATION THAT EXCLUDED THE MESBIC AND SBIC INDUSTRIES -- THE VERY INDUSTRIES SET UP TO PROVIDE VENTURE CAPITAL TO HIGH GROWTH FIRMS. DURING 1984, OVER 37% OF MESBIC INVESTMENTS WERE TARGETED TOWARDS FIRMS IN THE TRANSPORTATION, COMMUNICATIONS, AND UTILITIES INDUSTRIES. IN FACT, MESBICs HAVE INVESTED IN OVER 75% OF THE MINORITY-OWNED COMMUNICATIONS AND TELECOMMUNICATIONS PROPERTIES ACROSS THE COUNTRY. THE EXPERTISE OF THOSE INVESTMENT COMPANIES HAS BEEN RESPONSIBLE FOR FINANCING THE MAJORITY OF MINORITY CABLE FRANCHISES IN THE COUNTRY. WHILE OTHER PROGRAMS ARE PROVIDING SUPPORT SERVICES THROUGH PROCUREMENT PROGRAMS, MINORITY VENDOR ACTIVITIES, AND FAIR SHARE AGREEMENTS, MESBICs ARE CREATING BUSINESS OPPORTUNITIES, EXPANDING EXISTING BUSINESSES, AND INVESTING IN A COMPANY'S LONG TERM SUCCESS.

ALTHOUGH OUR STATISTICAL PROFILE IS IMPRESSIVE, I THINK ILLUSTRATING OUR PROGRESS BY WAY OF PARTICULAR EXAMPLES WILL DEMONSTRATE MORE EFFECTIVELY THE IMPACT THIS INDUSTRY HAS HAD IN INSTITUTIONALIZING A STRONGER MINORITY BUSINESS SECTOR IN THIS COUNTRY.

In Connecticut, a consortium of MESBICs invested in PKS Communications, a minority-owned telecommunications telephone firm, which was recently taken public.

In New York, MESBICs provided early stage financing to Essence Magazine. As you learned from Essence publisher Ed Lewis' testimony before your committee a few weeks ago, Essence now has a circulation of 800,000 and advertising revenues of $11 million. Essence creates and reinforces a positive image of blacks in the black community at the same time it serves as a communications link between corporate America and the black consumer.

Also in New York, Canal Plastics Company, a hispanic owned manufacturing firm, located in the lower east side of Manhattan, manufactures a menu of plastic types of materials. The investment funds came from Triad Capital Corporation located in the Bronx in New York.

In Minnesota, MESBICs participated in a $4.3 million deal financing the operation of a UHF-independent TV station which covers two-thirds of Minnesota, including Minneapolis, St. Paul, and other metropolitan areas.

IN MICHIGAN, A MESBIC FUNDED BY GENERAL MOTORS HAS INVESTED IN SEVERAL INNOVATIVE SMALL BUSINESSES IN THE AREAS OF INDUSTRIAL COATING, PLASTICS INJECTION MOLDING, AND OTHER MANUFACTURING SECTORS. THIS MESBIC ALSO PROVIDED FUNDS TO DIGITRON, INC., AN OHIO-BASED TOOL AND DIE MANUFACTURER STARTED BY CUBAN REFUGEES. DIGITRON HAS GONE FROM 2 TO 200 EMPLOYEES IN SEVEN YEARS.

IN MONTANA, MESBICS INVESTED TWO ROUNDS OF FINANCING IN THE BLACKFEET INDIAN WRITING COMPANY. THE COMPANY EMPLOYS MORE THAN 175 NATIVE AMERICANS AND PRODUCES ITS GOODS ON THE BLACKFEET INDIAN RESERVATION. THE COMPANY MANUFACTURES WRITING INSTRUMENTS, IN ITS PLANT IN NORTHWESTERN MONTANA WITH SALES TODAY IN EXCESS OF $4 MILLION. ARTICLES ABOUT THE COMPANY HAVE APPEARED IN FORBES, TIME AND NATION'S BUSINESS.

IN CALIFORNIA, THE X-TEN CORPORATION, A START-UP COMPANY WHICH DESIGNED AN EXTENDABLE VERSACHASIS WHICH IS CAPABLE OF HANDLING ALL SIZE CONTAINERS EFFICIENTLY. THIS NEW PRODUCT HAS REVOLUTIONIZED THE TRANSPORTATION INDUSTRY. THE EXPENDABLE VERACHASIS MARKET IS ATTRACTIVE TO ALL MODES OF TRANSPORTATION, MARINE, RAIL AND OVER THE ~~ROD~~E.-

In **Wisconsin**, MESBICs financed the only Milwaukee based minority owned banking institution in the state. Providing leadership in this investment was Tower Ventures, a wholly owned subsidiary of Sears.

In **Washington** state, Seattle Community Cablevision, Inc., a black owned company serving 11,000 homes in the central district of Seattle, received equity financing from SYNCOM Capital Corporation, a MESBIC specializing in communications.

In Illinois, several minority owned, multi-store franchise owners of McDonalds, Burger King and Popeye all received their initial capital for their first operations from the Urban Fund of Illinois in Chicago. This investment company has now financed Chicken George, the first major national minority owned franchisor.

In **Tennessee**, North Memphis Home Health Care Company, a start-up company which took advantage of the new niche in the health care field had sales of approximately $400,000 and employs twenty employees after only a year in business.

IN SUMMARY, CONTRARY TO MR. STOCKMAN'S CLAIMS, SBA PROGRAMS ARE NOT AN "UNNECESSARY LUXURY". THE MESBIC PROGRAM IS SUCCESSFUL IN PROVIDING MUCH-NEEDED CAPITAL AND TECHNICAL ASSISTANCE TO MINORITY-OWNED BUSINESSES, MANY OF WHICH ARE IN WHAT HE REFERS TO AS SUNRISE INDUSTRIES. THESE INVESTMENTS GENERATE JOBS AND, AS I HAVE DEMONSTRATED, FEDERAL TAXES REVENUES. AS PRESIDENT REAGAN POINTED OUT IN HIS TAPE SHOWN BEFORE THIS COMMITTEE LAST WEEK, MESBICS DO PLAY AN IMPORTANT ROLE IN THE AMERICAN ECONOMY.

MESBIC INVESTMENT STATISTICS 1984

	Financings 1984
Total Number of MESBIC Financings	1,087
Estimated Revenue of MESBIC Portfolio Co.	88,731,000
Estimated Total Employees	14,131
Est. Portfolio Co. Employee Payroll Tax	
Federal Taxes	38,153,700
State and Local Taxes	12,717,900
	50,871,600
Est. Portfolio Co. Corp. Taxes Paid:	
Federal	11,046,637
State/Local	3,976,789
	15,023,426
Est. Payroll Taxes Collected	
FICA: Employees	15,897,375
Company	15,897,375
Total	31,794,750
Unemployment Taxes:	
Federal	572,305
State	4,451,265
	5,023,570
Total Governmental Collections	102,710,000
Unemployment Wages Saved	82,666,350
Annual Federal and State Tax Benefit	185,376,350
Annual Federal Revenue Benefit	164,230,000
Cost to Taxpayer SBA Leverage Cost)	
Preferred Stock	12,500,000
Debentures	828,000
	13,328,000
Excess of Government Revenue over Cost	150,902,000
Government Cost to Benefit Ratio	12.32
Government Return on Annual Investment	1,132%

MESBIC INVESTMENT STATISTICS 1978-1984

	Financings 1978-1984
Total Number of MESBIC Financings	4,472
Estimated Revenue of MESBIC Portfolio Co.	3,707,288,000
Estimated Total Employees	68,256
Est. Portfolio Co. Employee Payroll Tax	
Federal Taxes	184,290,000
State and Local Taxes	61,430,400
	245,720,400
Est. Portfolio Co. Corp. Taxes Paid:	
Federal	46,341,100
State/Local	16,682,796
	63,023,896
Estimated Payroll Taxes Collected	
FICA: Employees	76,788,000
Company	76,788,000
Total	153,580,000
Unemployment Taxes:	
Federal	2,764,368
State	21,500,640
	24,265,008
Total Governmental Collections	486,589,304
Unemployment Wages Saved	399,300,000
Annual Federal and State Tax Benefit	885,889,304
Annual Federal Revenue Benefit	786,280,000
Cost to Taxpayer (SBA Leverage Cost)	
Preferred Stock	87,500,000
Debentures	5,796,000
	93,296,000
Excess of Government Revenue over Cost	692,984,000
Government Return on Annual Investment	1,132%

The CHAIRMAN. Mr. Burns, thank you very much.

As I indicated, we will move on with the testimony and then come back for the questions.

Our next witness is Mr. Martin Orr, the President of the National Association of Development Co. Mr. Orr.

STATEMENT OF J. MARTIN ORR, EXECUTIVE VICE PRESIDENT, KANSAS CITY CORP. FOR INDUSTRIAL DEVELOPMENT, AND PRESIDENT, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES

Mr. ORR. Thank you and good morning. I appreciate having the opportunity to be here.

My name is Martin Orr. I am executive vice president of the Kansas City Corp. for Industrial Development and president of the National Association of Development Companies.

For 16 years, I have been serving as an economic development professional in the State of Missouri. Our local organization assists approximately 400 businesses a year. Almost all of them are small businesses.

Our organization was a founding member of the NADCO, National Association of Development Co. NADCO is a national organization of SBA 503 certified development companies. NADCO represents the largest and most active CDC's in the United States.

With that background, I want to bring a real-world perspective on SBA and small business development.

Last week, Mr. Stockman presented you with his fancy statistics and theoretical model of small business development. He further stated that he could find no public purpose for SBA. How many Governors, mayors, county commissioners or members of this committee did he ask for help in finding a public purpose?

He misses the real point about SBA. There is a rationale to SBA, especially to the SBA 503 and SBIC programs, and that rationale is a need to fill the long-term credit gap of growing small businesses.

No one, including Mr. Stockman, has contested the importance of small businesses. Their job-creation role, generation of tax revenues, and flexibility for innovation are well accepted.

However, he says SBA is not needed because it serves such a small percent of all small businesses. Bologna! Again, I want to mention, the purpose is filling the long-term credit gap of growing small businesses.

The substantial majority of all small businesses are neighborhood and small community oriented businesses, businesses with limited service areas, limited product lines, which lack a growth opportunity, and in many cases, from my personal knowledge, do not want to grow to become larger businesses.

Although important to their customers, such businesses do not fulfill the long-term economic development goals of our local community. Job creation results from those businesses interested in growing, increasing their profits and increasing their size and thus benefiting our local communities.

Those growing companies need the SBA 503 and small business investment company programs to meet that credit gap. Without

SBA, and especially the 503 and SBIC programs, what will happen to these small businesses?

Commercial banks have historically been short-term lenders. Today, with deregulation and more opportunities in the money market, commercial banks have even less desire and need to get involved in long-term lending, and thus we find 3- to 5-year-term loans for our small businesses.

Insurance companies and pension funds, while providing long-term financing, provide such financing to large projects. There are two advantages for them to do that. One, it costs no more to do a $5 million loan than it does to do a $50,000 loan. Second, a large project probably comes in with full documentation, whereas a small project takes a lot more work for the loan officer.

Investment banking, again, predominantly works on larger projects and, as was mentioned, really looks more toward drastic growth opportunities and not the typical good, sound small business.

It has been suggested that we return to two or three generations ago and rely again on the family member for investing and putting capital in our small businesses. In our educated society, our family members and individuals have many other alternatives for investing their money without the risk of investing in a small business.

Without SBA, what will happen? There will be no long-term capital for many of our small businesses. Small businesses will remain that—very small businesses.

The SBA 503 and SBIC Programs are designed to provide capital in partnership with local private funds and local private lenders. We do not replace, but we do supplement, the private capital at our local levels.

Further, we provide the impetus and the comfort to those local lenders to make loans to qualified small businesses, and I want to emphasize, we are talking about qualified small businesses. Our credibility is on the line. As we make loans, we are doing it on behalf of our local communities and our boards of directors.

Mr. Stockman has implied that SBA makes loans to weak and failing businesses. The opposite is true for us. He reported a 10-percent loss ratio for the SBA 503 Program. Bull roar! The actual rate is only about 1.6 percent, and this is more than offset by the taxes being generated by those businesses as they have grown and increased employment.

Again, the rationale for our programs is a need to fill the long-term credit gap for the growing small businesses. This results in the public purpose, and that public purpose is the creation of jobs and tax revenues for our local communities and the Nation as a whole.

The SBA 503 and SBIC Programs also meet another public purpose, and this has also been alluded to, and that is they increase the capital available in our local communities. Rural banks and small urban banks cannot meet the needs of their local communities.

I would like to summarize and emphasize again five points: SBA does have a public purpose, and that is the creation of jobs and tax revenues for our local communities and the United States.

Second, SBA must be measured on fulfilling its purpose, and that is service to growing and expanding businesses.

Third, SBA 503 and SBIC Programs uniquely meet the long-term credit needs of such growing businesses.

Fourth, SBA 503, while participating in almost $2 billion of fixed-asset financing, has a very low—very low—loss rate.

And, finally, SBA 503 and SBIC Programs are a sound partnership between the Federal Government and local leaders. We effectively leverage a limited amount of public funds with private investments at the local level, and we effectively utilize local leadership, public and private, and local organization staffs in delivering a service that otherwise has been provided out of the Federal budget.

I want to make one comment, that we have been informed and recognize that an accounting has classified us now as a direct loan program. We do not feel that that is a key issue right now. We feel that the programs should be measured on their merit, and we are submitting our testimony in that regard.

As a dumb old farm boy from north Missouri, I can say that you don't throw out the seed corn just because things are bad, because you want to be back next year, and SBA is the seed corn for our small businesses in this country.

Thank you.

[The prepared statement of Mr. Orr follows:]

STATEMENT

on the

SBA AUTHORIZATION BILL (S. 408)

with emphasis on the SBA 503 Program

before the

SENATE SMALL BUSINESS COMMITTEE

by

J. Martin Orr

March 7, 1985

Good morning! I appreciate the opportunity you have given me. I am Martin Orr, Executive Vice President of the Kansas City Corporation for Industrial Development and President of the National Association of Development Companies.

I have over sixteen years experience as an economic development professional in Missouri. Our local organization assists approximately 400 businesses per year, almost all of which are small businesses. I was a founding member of NADCO. NADCO is the national association of SBA 503 Certified Development Companies. Our membership includes the largest and most active development companies in the United States.

With this background, I bring a real world perspective to you. Last week, Mr. David Stockman submitted his mostly unsubstantiated - academic theory of small business development. Although, he said "obviously numbers are not the bottom line", he inundated you with pages of fascinating statistics. Mr. Stockman further stated that he could not identify a public purpose for SBA. How many mayors, county commissioners or even members of this committee has he consulted? From my perspective, he completely missed the point. He did not recognize the real rationale for the SBA 503 program, the Small Business Investment Company program, and to a large extent the SBA 7(a) loan guarantee program. What is that rationale? It is the long-term capital gap for smaller businesses. My testimony herein is submitted in two parts: comments in response to testimony by David Stockman and specific comments about the SBA 503 program.

I. Response to David Stockman.

No one, including Mr. Stockman, contests the importance of small businesses. They provide jobs, tax revenues, services, and innovation for our communities and the United States. However, he portends that because only a small percent of such small businesses use SBA programs, there is no need for SBA. This couldn't be further from the truth. The substantial majority of small businesses are neighborhood or small community retail or service businesses with limited markets and lack of growth opportunity--and in many cases desire. Such companies are important to their customers but do not meet the long-term economic development objectives of our local communities. Job creation results from small businesses expanding their market area and the number of their products and services. It is those growing companies that the SBA 503, SBIC and much of 7(a) programs are directed. For them the long-term capital gap can be limiting.

Without SBA and especially the 503 and SBIC programs, what will happen? Commercial banks have historically avoided long-term debt. With deregulation and interest volitility of recent years, there is even less desire by commercial banks to make loans with terms beyond three or five years. Insurance companies and pension funds, while making long-term commitments, seek large projects. They are able to invest several million dollars with one loan closing and have the comfort of extensive financial background that goes with a large project. Mr. Stockman has suggested that capital come from family members. In our society of educated individuals, family members often look for the greatest return with minimum risk. Through deregulation, family members have many more alternatives now than were available a few years ago. Investment bankers become interested only if we can show them a strong growth opportunity--or more likely a strong growth history--with a project of sufficient size to justify their fees. Thus, without SBA, small businesses have no access to long-term capital and are destined to remain small.

The SBA 503 and SBIC programs are designed to provide long-term capital--in partnership with local private capital. The programs do not replace the private marketplace. They supplement the private capital market and provide the necessary impetus to bring the private capital to qualified small businesses. Let me emphasize the term qualified. Those of us administering SBA 503 and SBIC programs are looking for quality deals that have a track record and opportunity for growth. Our local communities support us because they know we will create jobs and tax revenues for them--long-term jobs and tax revenues. Mr. Stockman has implied that SBA concentrates on weak and failing businesses. The opposite is true for us. From some unknown source, he says there is a ten percent loss ratio for SBA 503. The actual loss ratio is only 1.6 percent--far offset by new taxes generated by the expansion of the majority of small businesses which we assist.

Again, the rationale of SBA 503 and SBIC programs is to fill the long-term capital gap. The resulting product is the public purpose--the creation of jobs and tax revenues for our local communities. The SBA programs serve another purpose. The programs increase the amount of capital available to many of our country's local communities. Rural banks and small urban banks can not meet all local needs. Thus, the SBA programs serve a further public purpose: to increase the overall level of capital in local communities.

In summary of my introductory comments, I want to re-emphasize the following five points.

1. SBA does have a public purpose--the creation of jobs and tax revenues for local communities.

2. SBA must be measured against the service it provides to growing small businesses and not against all small businesses.

3. SBA, through the 503 program and SBIC program, uniquely fills the long-term credit gap of growing small businesses.

4. The SBA 503 program while participating in almost $2 billion of capital growth in this country has a very, very small loss ratio--much less than the local and national positive impact it generates through jobs and tax revenues.

5. The SBA 503 program is a sound partnership approach to leverage limited public funds with local private investment dollars--with a payback to all parties involved.

The balance of my testimony focuses on more specifics regarding the SBA 503 program.

II. Specifics about the SBA 503 Program.

The Small Business Administration's 503 lending program, established in 1980 by section 503 of the Small Business Investment Act, provides long-term, fixed asset financing to qualified small businesses through local development companies certified by the SBA. The program is designed to work in conjunction with private sources of funding. It enables private lenders, such as banks, to provide adequate financing to small firms needing facilities in which to set up a new business or expand an existing one. The focus of the 503 program is job creation and economic revitalization through private/public partnerships. To this end, it has proven to be a huge success.

PUBLIC/PRIVATE PARTNERSHIP FOR EFFECTIVE JOB CREATION

Since its inception, the 503 program has issued $703,735,000 worth of debentures, which in turn has leveraged more than $1 billion in private capital to create nearly 100,000 job opportunities throughout the country, at an average federal investment of $7,394.00 per job. The Attachment to this document illustrates, by state and by federal region, the total debenture amount issued by SBA, the number of jobs created, and the average investment per job. SBA's investment -- up to 40 percent of a project's total cost -- makes a financing package affordable to small companies by lowering the combined interest rate (503 loans are made at Treasury bill rates plus 3/4 of one percent for servicing), and by extending repayment terms (503 loans are made for up to 25 years; bank loans issued in conjunction with the 503 loan must be for at least 10 years.) Many banks have stated publicly that such long-term financing would not be possible without the 503 program and others like it.

LEVERAGING PRIVATE FUNDING MAGNIFIES THE ECONOMIC EFFECT

The 503 program's impact is much greater than its size would initially suggest. In fact, the program and its predecessor -- the 502 loan program -- have been the cornerstone of many local and state economic development programs for the better part of a decade. Recognizing the inherent inability of a small business to tap into this nation's long-term capital markets, the 503 program permits a community to initiate its own economic development activities to overcome this structural disfunction in our economy. Also, recognizing the scarcity of public resources, the 503 program is designed to supplement, not supplant, private sector financing from conventional institutions.

In establishing the 503 program, Congress made CDCs a major partner sharing responsibility for loan origination, packaging, closing, monitoring and servicing. In order to become a CDC, an organization must demonstrate broad and active community support and professional staff resources. Many local and state public officials believe economic development in their areas would come to a virtual halt without the 503 program.

Economic revitalization of cities and rural areas alike is the direct result of projects financed in part by the 503 program. Close to 100,000 jobs have been created or preserved as a result of this program -- jobs that add to the nation's employment, tax revenues, and economic well-being. For the most part, the jobs created are unskilled or require little training and experience. These are the jobs that take -- and keep -- people off the welfare roles, and hold the line on unemployment compensation and other federal programs designed to assist the unemployed. In other words, this federal jobs program works by targeting jobs to the areas and people who need them most.

LONGER TERM FINANCING AT AFFORDABLE RATES

The program can make the difference between getting a chance to grow and stagnating. For example, a tool and die company in Columbus, Ohio, wanted to construct a much larger facility and add equipment in order to take advantage of government contracting opportunities. Total cost of the project was $400,000. The firm's bank offered it 5 years on 70 percent of the equipment costs, at a floating rate 2 percent over prime. On the real estate, the bank offered 10 years on 70 percent of the cost (ballooning at 7 years), at prime plus 1 1/2 percent. The business's first year debt service would have been $57,300. Downpayment would have been $120,000.

The situation changed when the 503 became involved. Since the bank's portion of financing was reduced to 50 percent, it agreed to make one consolidated loan, with a 15-year term, at prime, plus 1 percent. The annual cost to the business was reduced by about $14,000 because of the 503 - and its downpayment fell from $120,000 to $40,000. The business could not have afforded the expansion without the 503.

PRODUCING JOBS WHERE THEY ARE NEEDED MOST

The dual role of economic revitalization/job creation and small business assistance is apparent in Goglia Enterprises' story of success.

Goglia Enterprises, formerly Goglia Dress Company, has been located in New Haven, Connecticut since it was founded in 1965. The company is a cut and sew operation and services large firms in the New York area. A new division of the company manufactures silk screening T-shirts for sporting goods stores in the greater New Haven area. The company is also involved with the embroidering of high quality fashion garments and in the personalization of sportswear. This firm has kept pace with changing style preferences and most recently has entered into the manufacture of polo shirts and sweaters for the sportswear industry.

Located in an antiquated factory building on the upper two floors, the company obviously needed new quarters to expand and streamline its operations. Ever mindful of the competition of foreign markets and the highly competitive industry they are engaged in, the present owners, Michael and Domenic Goglia, sought the City's assistance in locating a suitable building and for financing required for its purchase and rehablitation. New machinery to modernize its operations and sufficient working capital were also needed to insure the company's success.

The New Haven Community Investment Corporation (NHCIC) worked with Goglia Enterprises to package an SBA/503 loan. An SBA 7(a) loan was also provided in conjunction with the 503 loan for acquisition of new machinery and equipment and for working capital necessary for the company's newest operations. Without the aid of this program, Goglia would not have had the ability financially to expand and relocate its business to a new and modern facility. New Haven would have been denied the 60 new jobs that were added to the company's payroll as a result of the 503 assisted expansion. The building they purchased had been vacant for two years. With the construction of an additional 3,000 s.f., the property was returned -- with an increase in dollar value -- to the City's tax rolls.

The program's benefits are not limited to urban areas, by any means. In Brunswick, Georgia, the Coastal Area District Development Authority, a certified development company, recently financed a 503 loan to construct facilities for Jean's Old South Truck Plaza in Eulonia, Georgia. Eulonia is in McIntosh County between Savannah and Brunswick just off Interstate 95. A $99,000 503 loan for this project leveraged $117,000 in private financing. Upon completion, scheduled for early summer of this year, Jean's Old South Truck Plaza will provide 22 new full-time jobs to the area, making the business one of the largest employers in McIntosh County, which is one of the poorest counties in the state of Georgia.

Dissolving the private/public partnership the 503 program has created would cost considerably more than the SBA's portion of capital investment. According to David L. Huff, Senior Vice President of the First Wisconsin Bank of Oshkosh, eliminating SBA credit programs would mean that "many small business entrepreneurs would not have an opportunity to start or expand their businesses. Many jobs created by small businesses would simply not be available without some continued support of SBA lending programs."

"Wisconsin is among the leaders in the use of the Small Business Administration's 503 and 7(a) loan programs, and will, I believe, continue to be in the future if these programs are available...[SBA programs] provide integral financing tools for small businesses in Wisconsin."

Indeed, the 503 program in Wisconsin has provided nearly 3,000 job oportunities since it began operation in 1981.

THE 503 PROGRAM IS NOT A DRAIN ON THE FEDERAL BUDGET

Much has been said of late about the need to eliminate the "luxury" of SBA credit programs in order to reduce the deficit. Yet, the 503 program is actually adding to federal revenues, not draining federal resources. The more than 3,500 companies participating in the 503 program and the 100,000 employees who are gainfully employed as a direct result of that program pay taxes, contribute to their communities, reduce unemployment and stimulate competition. And contrary to the assertions of Budget Director David Stockman when he spoke before this Committee last week, the loss rate on the program is only 1.6 percent -- a far cry from the 10 percent loss rate indicated in his supporting documents.

Rhetoric such as this, which leads Congress, the President and the American public to believe they cannot afford a program that stimulates the very activity needed to turn the deficit around, cannot be tolerated. Incorrect numbers and irrelevant facts do not serve the public interest -- they erode it. The SBA 503 program has demonstrated its effectiveness at job creation and economic revitalization. What's more, it achieves these goals at minimal cost to the taxpayer.

The program is not a hand-out, nor does it give participating companies an unfair advantage over non-SBA assisted firms. On the contrary, it puts companies that are outside the credit market because of inexperience or insufficient collateral on a level playing field with other firms by providing financing at competitive rates. The vast majority of these companies -- all but one-to-two percent -- fulfill their commitment to repay. This extremely low loss rate is due in part to the delivery system -- the CDCs -- and their ability to evaluate situations and invest scarce public funds wisely. The country is well served by the 503 program; it should be maintained.

I appreciate the opportunity to testify before this Committee today on the SBA 503 lending program. I would be happy to anwer any questions you may have.

ATTACHMENT

JOB CREATION THROUGH THE SBA 503 PROGRAM

	CDCs Sampled		CDCs Not Sampled					
States	SBA Debentures	Job Opportunities	SBA Debentures	Regional Average	Job Opportns	Total Job Opportns	Total SBA Debentures	Average Per Job
Region I	48,564,960	4,141	24,838,040	11,727	2,118	6,259	73,403,000	11,728
Massachusetts	30,298,960	2,958	11,266,040		961	3,919	41,565,000	10,606
Maine			6,240,000		532	532	6,240,000	11,729
Vermont	1,988,000	334	2,831,000		241	575	4,819,000	8,381
New Hampshire			2,013,000		172	172	2,013,000	11,703
Connecticut	4,128,000	390	1,103,000		94	484	5,231,000	10,808
Rhode Island	12,150,000	459	1,385,000		118	577	13,535,000	23,458
Region II	40,124,248	6,540	8,404,752	6,135	1,370	7,910	48,529,000	6,135
New York	34,052,250	6,331	5,177,750		844	7,175	39,230,000	5,468
New Jersey	6,071,998	209	1,325,002		216	425	7,397,000	17,405
Puerto Rico			1,902,000		310	310	1,902,000	6,135
Region III	6,580,000	706	31,928,000	9,322	3,425	4,131	38,508,000	9,322
Pennsylvania	1,100,000	199	14,043,000		1,507	1,706	15,143,000	8,876
Delaware			1,746,000		187	187	1,746,000	9,337
Maryland	3,751,000	398	8,446,000		906	1,304	12,197,000	9,354
Virginia	1,729,000	109	1,043,000		112	221	2,772,000	12,543
West Virginia			585,000		63	63	585,000	9,286
District of Columbia			6,065,000		650	650	6,065,000	9,331
Region IV	46,176,015	7,109	32,052,985	6,496	4,934	12,043	78,229,000	6,496
Georgia	7,069,640	1,074	9,781,435		1,506	2,580	16,851,075	6,531
Tennessee	2,829,000	427	1,528,000		235	662	4,357,000	6,582
Kentucky	6,658,000	1,048	8,541,000		1,315	2,363	15,199,000	6,432
North Carolina	11,453,000	1,713	4,839,000		745	2,458	16,292,000	6,628
South Carolina	1,733,000	88	3,958,000		609	697	5,691,000	8,165
Florida	3,371,450	994	1,209,550		186	1,180	4,581,000	3,882
Alabama	8,883,925	1,030				1,030	8,883,925	8,625
Mississippi	4,178,000	735	2,196,000		338	1,073	6,374,000	5,940
Region V	104,632,400	13,504	58,812,600	7,749	7,590	21,094	163,445,000	7,748
Illinois	15,051,000	1,716	9,231,000		1,191	2,907	24,282,000	8,353
Indiana	2,976,000	447	5,497,000		709	1,156	8,473,000	7,330
Michigan	19,468,000	2,035	16,401,000		2,117	4,152	35,869,000	8,639
Ohio	38,485,400	6,364	18,665,600		2,409	8,773	57,151,000	6,514
Minnesota	6,047,000	945	2,954,000		381	1,326	9,001,000	6,788
Wisconsin	22,605,000	1,997	6,064,000		783	2,780	28,669,000	10,313
Region VI	31,956,745	3,429	21,412,255	9,322	2,297	5,726	53,369,000	9,320
Texas	22,157,745	2,017	709,255		76	2,093	22,867,000	10,925
Arkansas			14,759,000		1,584	1,584	14,759,000	9,318
Louisiana	3,745,000	716	4,700,000		504	1,220	8,445,000	6,922
Oklahoma	6,054,000	696	1,244,000		133	829	7,298,000	8,803
New Mexico								
Region VII	43,057,983	11,470	16,404,017	3,755	4,369	15,839	59,462,000	3,754
Missouri	31,248,983	10,236	7,239,017		1,928	12,214	38,488,000	3,151
Iowa	3,023,000	215	6,934,000		1,847	2,062	9,957,000	4,829
Nebraska	4,066,000	531	552,000		147	678	4,618,000	6,811
Kansas	4,720,000	438	1,679,000		447	885	6,399,000	7,231
Region VIII	9,171,000	818	8,663,000	11,207	773	1,591	17,834,000	11,209
Colorado	1,945,000	268	2,563,000		229	497	4,508,000	9,070
Utah	7,226,000	550	1,616,000		144	694	8,842,000	12,741
Wyoming			379,000		34	34	379,000	11,147

	SBA Debentures	Job Opportunities	SBA Debentures	Regional Average	Job Opps.	Total Job Opps	Total SBA Deben.	Average Per Job
North Dakota			827,000		163	163	827,000	5,074
South Dakota			779,000		159	159	779,000	4,899
Montana			499,000		44	44	499,000	11,341
Region IX	97,694,000	11,360	23,933,000	8,597	2,784	14,144	121,527,000	6,599
California	87,506,000	10,743	15,814,000		1,839	12,582	103,320,000	8,212
Arizona	10,188,000	617	4,571,000		532	1,149	14,759,000	12,845
Hawaii			2,347,000		273	273	2,347,000	8,597
Nevada			1,201,000		140	140	1,201,000	8,579
Region X	36,647,340	4,780	12,681,660	7,667	1,654	6,434	49,329,000	7,667
Washington	26,324,340	3,973	4,325,660		564	4,537	30,650,000	6,755
Oregon	10,323,000	807	2,667,000		348	1,155	12,990,000	11,247
Idaho			1,825,000		238	238	1,825,000	7,668
Alaska			3,864,000		504	504	3,864,000	7,667
TOTALS	464,604,691	63,857	239,130,309		31,314	95,171	703,735,000	7,394

Senator **Bumpers** [acting chairman]. Thank you, Mr. Orr.

The only comment I would have, and possibly ask you to comment on, is that Mr. Stockman, as you know, testified last week essentially that these people that have been helped not only by MESBIC's but by the Guaranteed Loan Program, that they could have made it, anyway, that somehow or other there would be just as many jobs and that these same people would have gone into business and stayed in businesses, and they would have been just as successful, whether it was Apple or Digital Switch or whoever, if there never had been such a thing as SBA.

On the other hand, he testified that all SBA does is take away from creditworthy people and give it to unworthy people. So he was essentially calling Apple and all those corporations, the list of which I read off to him, unworthy. If they were unworthy, obviously, they would never have gotten credit.

It seems to me that that is a strange contradiction in his testimony. Do you see it that way or not, Mr. Orr?

Mr. **Orr.** Oh, I agree. I think small businesses, to a conventional lender, oftentimes are classified as not creditworthy. They can have a 10-year or a 40-year successful track record.

We are working with a company right now that has been in existence for 40 years. It has been profitable for almost all of its history. However, they have been unable to acquire financing for an expansion of that company. The son, who is relatively young—he is in his mid-forties—just acquired the company from his father, and he has had to use an SBA 503 loan in order to come up with a second mortgage in order to provide the fixed-asset financing that they need.

It is a small company, and it does not have the 10-K form and everything else that goes with a large corporation for financial expansion.

Mr. **Burns.** Senator, may I comment on that for 1 second?

Senator **Bumpers.** Absolutely.

Mr. **Burns.** I think the thesis that funds are flowing from worthy borrowers to unworthy borrowers is—I am hesitant to say false because that sounds awfully strong, but in point of fact, I think it is.

The decision for a financial institution to utilize its resources, as you well know, is not necessarily to lend, but it could very well, as many banks do, buy Government securities. The encouragement of a loan to a small business does not discourage the bank from carrying on its normal financing activities for stronger small and medium-sized businesses.

As a point of fact, in the MESBIC industry, ironically enough, or to prove the point sufficiently, one of our major sources of referral is commercial banks who say, We would like to deal with this situation, but it is too young, it is too weak, there is not enough collateral.

I almost have this speech memorized. If you would put in some patient capital for 10 years—you, the MESBIC—and if we can get an SBA-guaranteed loan for this amount, we can then see our way clear to providing the financing for this particular business which does not meet our, in quotes, normal standards. The choice is not taking the funds away from a, quote, normal standard but just not utilizing them in support of small business.

Usually, that business is geographically disadvantaged. I happen to be a dumb city boy from New York, and living in Brooklyn, I know there are areas of Brooklyn that commercial banks are singularly unenthusiastic about financing businesses in, period, and that is the kind of small business customer, no matter what Mr. Stockman has to say, that has no alternative source of financing except these creative, flexible, and credit-strong programs, the SBIC Program, the 503 Program, and the Loan Guarantee Program.

Senator **Bumpers**. What interest rate do your businesses pay? Normally, in lending financial assistance, you take an equity position with most of your clients, do you not?

Mr. **Burns**. In the MESBIC industry, it varies from companies that are more highly socially motivated, who will lend at the prime rate of interest or less and take no equity position, to companies such as our own, which is an equity-focused investor. Our standard transaction, to the extent that we have one, to use us as a for-instance, would be for a patient debt, probably 6 to 10 years, at an interest rate that probably is slightly above prime, maybe 2 points above prime, with warrants.

Part of our dilemma—not to go off too much on a tangent, of course—is that we have to balance the funds we pay SBA. We are paying SBA right now 11 percent on funds that we have borrowed from them. So we have to, unfortunately, lend at least at 11 percent or more just to pay the rent.

Mr. **Thomas**. Senator, could I comment on the question regarding interest rate, because the SBIC's, as distinguished from the MESBIC's, have tended to—especially during recent years—veer more toward equity investments. In fact, nearly half of the activity of SBIC's in recent years has been investments in the form of preferred and common stock. So while the preferred may have a dividend requirement, in the absence of earnings, that dividend obviously will not be paid.

The debt securities typically are subordinated-debt securities, and they do have an interest rate. That rate varies widely depending on the equity participation involved and the state of the company and its ability to service debt. But generally, those would range, in my experience, probably in the 10-to 15-percent range.

Nevertheless, the important thing is that the interest service is tailored to the indicated capability of that firm receiving the financing.

Senator **Bumpers**. Mr. Burns, at the back of your testimony, you attached a table on the first sheet there that says "MESBIC Investment Statistics for 1984."

Mr. **Burns**. Senator, if I say that I am not responsible for errors of this chart, will I get off the question? [Laughter.]

I have already pointed out, sir, earlier, that we managed to have the Government collecting more revenues than we had our portfolio companies——

Senator **Bumpers**. That is the only point I want to make. [Laughter.]

Mr. **Burns**. That we are being unnecessarily optimistic. The number should be $883 million, not $88 million for the revenues of the portfolio companies, and we are going to submit a corrected page.

sick, children coughing, one doctor there to take care of all of them, in the tenth poorest county in the United States—I could not help but wish the President could have been along.

And so I feel the same way about this. I am sorry the President and Mr. Stockman cannot go out and talk to the presidents of all these companies who have prospered so well because of just a small amount of Government help.

Thank you all very much for coming this morning.

Mr. THOMAS. Thank you, Senator.

Senator BUMPERS. Our third panel this morning consists of Brad Roller, president of Small Business United, accompanied by Lewis Shattuck, executive director of the Smaller Business Association of New England; Walter Galanty, Jr., chairman of the Small Business Legislative Council; Thomas E. Donley, director, Small Business Center for the U.S. Chamber of Commerce; and Frank Doyle, director of government affairs, Small Business Service Bureau, Worcester, MA.

Gentlemen, if I may, I would like to take you in the order in which your names appear on my list and start off with Mr. Roller. Please proceed, Mr. Roller.

STATEMENT OF BRAD ROLLER, PRESIDENT, SMALL BUSINESS UNITED, AND PRESIDENT, SWIGER COIL SYSTEMS, INC., ACCOMPANIED BY LEWIS A. SHATTUCK, EXECUTIVE VICE PRESIDENT, SMALLER BUSINESS ASSOCIATION OF NEW ENGLAND

Mr. ROLLER. Good morning.

I have submitted written testimony on behalf of SBU which I would like to have included as part of the record this morning.

Senator BUMPERS. Your statement will be entered in the record at the conclusion of your oral presentation, and we would appreciate your summary.

Mr. ROLLER. All right. I am also the president of Swiger Coil Systems in Cleveland, OH. We are a manufacturer of electric motor coils, and we do a considerable amount of business in the United States and export.

I am accompanied by Mr. Shattuck, who is the executive vice president of the Smaller Business Association of New England, who has previously been introduced to the committee.

SBU has just held their annual leadership retreat, where we gathered 100 of our leaders from around the Nation to pick our priority items for the coming year. We came up with a dead heat for our No. 1 priority. The first half of the dead heat was, and I quote, to maintain the independence of the SBA and support the passage of S. 408.

The other half of the No. 1 priority is to reduce the Federal deficit. David Stockman apparently thinks that those two items would contradict each other, and I would like to discuss that shortly.

As far as the independence of the Agency goes, President Eisenhower recognized the importance of small business to the Nation, and as far as economic development and job creation go, and he said that the way to emphasize its importance was to maintain an independent SBA.

Senator **Bumpers**. Are the bottom figures correct, then?

Mr. **Burns**. The bottom figures are correct to the extent——

Senator **Bumpers**. The Government collected in 1984 $150,902,000 more than it spent?

Mr. **Burns**. That is correct.

Senator **Bumpers**. For a return of 1,132 percent?

Mr. **Burns**. That is correct.

Senator **Bumpers**. Well, then it seems to me—and I will just summarize this—it seems to me that David Stockman's argument has very little to do with the deficit, has little to do with economic decisions. His argument is simply an ideological one that the Government should not involve itself in any business decisions.

I cannot reach any other conclusion. The testimony that we have had here and the statistics—you know that old story about liars can figure but figures don't lie—the statistics here are overwhelming.

Mr. **Burns**. Senator, I used that earlier.

Senator **Bumpers**. Oh, did you? [Laughter.]

I didn't have nerve enough to say "liar," though. I left it blank. [Laughter.]

Well, that is such an old saw, I couldn't imagine why people were giggling back there, because everybody has heard that expression, and obviously, they have now heard it twice this morning. [Laughter.]

But the figures are most impressive. As I pointed out to Mr. Stockman the other day, you know, Senator Weicker and I did not offer this bill lightly, or with a view toward seeing how much we could increase the deficit. We cut almost $700 million out of a 3-year bill in our proposal.

So, as I say, I think that Senator Weicker's and my differences with David Stockman are philosophical or ideological. I hate to use the word "ideological," but, you see, I think Government has a role in trying to promote small business and helping people who just otherwise are not going to be helped.

To assume that everybody that has been helped—the 4,000-and-some businesses that MESBIC's have helped, the 500,000 that SBA has helped—the assumption that all of that would have somehow or other come out in the wash and everybody would have been as well off if there had not been an SBA is a very specious argument to me.

So I want to congratulate you all on the work you are doing. MESBIC's do a magnificent job. They are the ones who really have helped most of these successful companies which have turned into big corporations, but were not before.

As I say, the other day I was visiting a clinic down in the southeastern part of my State. This has nothing to do with this hearing, but all the time I was going through this clinic, which is for poor people, and they were virtually all black, I was remembering that I had set up or signed off on a grant for this clinic for the first year I was Governor, one of the most controversial decisions of the past decade in my State.

But, in any event, now the clinic is virtually the primary health care center for that area. If you could have seen those poor people in there—at 5:30 in the evening, still 30 people in the waiting room

Fortunately, Congress has seen fit to continue the independence of the SBA over the last 25 years or so. Unfortunately, the administration at this particular moment doesn't seem to think that is such a good idea.

Certainly, with 435 Representatives and 100 Senators and their staffs spending 8 or 10 hours a day on Capitol Hill coming up with legislation and potential legislation, that puts thousands of people working in the legislative process. I don't think it is unreasonable—and, actually, I think it is mandatory—that we have an independent Office of Advocacy that is free from any political ramifications that might come by its being part of another agency of the Government.

I don't think that that is too much to ask, to have an independent Office of Advocacy. It has, over and over, shown that it has a knowledge of the needs of small business. Jim Sanders and Frank Swain have done a tremendous job with a very limited staff of protecting small business' interests.

As far as the Small Business Administration's impact on the deficit, the SBA is actually one of the few agencies that has decreased employment and decreased their budget since 1981. They have brought the private sector in a public-private partnership on 503 loans and other programs, and this is right in line with what the administration has asked the Government agencies to do. It amazes me and appalls me the thanks that the SBA gets for doing their job that the administration has asked them to do, that the administration here wants to abolish the SBA.

As far as dollar impact goes, getting rid of the guaranteed loan program absolutely has to cost the Government money. We have seen numbers over and over again that have said that the revenue that the Government gets from the taxes from the small businesses that have obtained loans more than compensates for the expense. Quite a bit of my testimony had something to do with this, and I don't think we need to go into those numbers any further.

Along with that, selling the loan portfolio, as Stockman has suggested, for just pennies on the dollar just doesn't make any sense at all. I mean, to give away loans for 19 cents on the dollar when you have an extremely good chance of collecting them, how that can positively impact the budget of the United States is just beyond me.

That pretty much summarizes what I had to say. I would like to add SBU's support again, though, to S. 408 and thank the committee for all the work they have done on behalf of the SBA and small business in general.

[The prepared statement of Mr. Roller follows:]

Statement Of

BRAD ROLLER
PRESIDENT
SMALL BUSINESS UNITED

AND

PRESIDENT
SWIGER COIL SYSTEMS, INC.
CLEVELAND, OHIO

Before

THE SENATE COMMITTEE ON SMALL BUSINESS

March 7, 1985

Washington, DC

Mr. Chairman, my name is Brad Roller. I am President of Small Business United (SBU), a national coalition of 16 regional, state, and metropolitan trade associations representing 70,000 small businesses. I am also the President and owner of Swiger Coil Systems, Inc., a closely-held small business located in Cleveland, Ohio. I am accompanied by Lewis A. Shattuck, Executive Vice-President of the Smaller Business Association of New England.

So as not to equivocate, let me make two points crystal clear. One, SBU adamantly opposes the Administration's proposal to abolish the Small Business Administration (SBA). We support the continued operation of the SBA as an independent federal agency. And two, we support Senate passage of S. 408.

First, let me speak to you regarding S. 408, which you and ten other members of the Committee have sponsored. The bill is entirely consistent with SBU's two top legislative priorities, namely, saving the SBA from elimination and freezing federal spending on an agency-by-agency, across-the-board basis. In fact, it amounts to a "freeze minus" in that it eliminates most direct lending by the agency. If cuts in the agency's budget are to be made, direct lending is where they should be made. As opposed to guaranteed lending, direct lending reaches fewer small businesses and in this time of fiscal crisis, the federal dollar should be made to stretch as far as possible.

As is well-known, SBA's primary lending program is the 7(a) business loan program, which enables commercial lenders to make long-term loans to small businesses which SBA guarantees to repay in the event of a default. In the 1930's, 40's and 50's, the Department of Commerce, the Federal Reserve Board and others conducted independent studies of small business financing. Each of these studies concluded there was a serious credit gap for small businesses because their access to equity and bond markets was very limited and banks were reluctant to lend them money on a long-term basis. Recently in April of 1983, before there was any discussion of abolishing the agency, the General Accounting Office (GAO) published a report entitled SBA's 7(a) Loan Guarantee Program: An Assessment of Its Role in the Financial Markets which clearly shows the 7(a) program is meeting a real need of small businesses.

According to GAO:

1) "About 82 percent of lenders responding [to a GAO questionnaire] indicated that 7(a) guaranteed loans either would not have been made without the SBA guarantee or would have been made on more stringent terms."

2) "Approximately 30 to 40 percent of the dollar amount of banks' long-term financing (six or more years) to small businesses may carry an SBA guarantee."

3) "Aside from satisfying a signficiant portion of small businesses' long-term capital needs, the SBA guarantee also provides larger loans than banks normally provide to small businesses. The average SBA loan is $118,000, or $60,000 higher than other small business loans."

Mr. Chairman, the 7(a) program works and works well. Recent efforts by the current SBA Administrator to utilize the private sector rather than the federal government to deliver SBA guaranteed loans, such as the preferred lenders program, are most welcome. If changes are to be made in the program, we suggest increasing the guarantee fee and instituting an annual fee on the outstanding balance of the loan. Such increases would help the program become self-supporting.

Similarly, we believe the 503 lending program should be continued. It is an outstanding example of a private-public sector partnership which has resulted in at least one new job being created per $15,000 of 503 financing. In its short period of existence (1980-1984), this program has resulted in the creation of over 100,000 jobs. This program should be left in tact with no changes as proposed in S. 408.

During the past 25 years, SBICs and MESBICs have invested $4.5 billion in 60,000 small companies. Companies benefiting from SBIC financing include Intel, Cray Research, Federal Express and Apple Computer. This program and its counterpart, the MESBIC program, should be continued.

Mr. Chairman, one area of SBA activity whose impact is difficult to quantify but is nevertheless exceptionally important is management assistance. In recent years, SBA has contracted out the assistance through Small Business Development Centers. We strongly support management assistance and the SBDC program. I want to deviate for a moment to briefly address some of the public criticisms of this program.

1) On the basis of the experience of our member organizations, we do not find that SBDC management assistance conflicts with private sector management consulting. In fact, the two activities are very often symbiotic.

2) Very often SBDCs coordinate or utilize private sector resources on a fee or volunteer basis to deliver

management assistance. For example, management assistance in the new Ohio SBDC will be delivered through local Chambers of Commerce.

3) In many instances, our 16 members report the SBDC management, while often located in a college or university, actually is very reflective of the private sector. For example, the SBDC Director in Maine was formally employed by a Wall Street banking firm; in Arkansas a CPA runs the SBDC; and in West Virginia, former Governor Cecil Underwood is the SBDC director. These people are not pie-in-the sky academicians; rather they have a firm knowledge and understanding of their local business community.

To reiterate, we urge the Committee to continue to support SBA's management assistance efforts and the SBDC program. In particular, we urge you to closely scrutinize the public criticisms of the SBDC program.

Now if I may, I would like to discuss the Administration's effort to abolish SBA. Proposed in the guise of deficit reduction, the Administration's proposal has nothing to do with balancing the federal budget.

Further, it totally ignores several critical points, the first being the independent status of SBA and the role Jim Sanders and Frank Swain play in advocating small business positions within the councils of government. The Administrator and the Chief Counsel for Advocacy are indispensable to the nation's 14 million small businesses as they are the only two people who can assure that small business' concerns are addressed by executive branch policy decisions. Transferring the SBA advocacy function to the Commerce Department is unacceptable. We find it hard to believe that in a cabinet council meeting an Under Secretary of Commerce for small business will speak freely and forcefully when the Secretary of Commerce is also in that meeting and holds a different viewpoint. In short, transferring the advocacy function to the Commerce Department means burying it.

Second, as stated earlier, the Administration's proposal ignores the efforts of Sanders and others to more fully incorporate the private sector into delivering SBA programs. The expansion of the certified lenders program is a good example of this effort. Other examples include expansion of the 503 program, inclusion of for-profit entities in the delivering of management assistance, and cooperative procurement programs with states. These efforts, and others, constitute good management. In our view, other federal agencies would do well by following SBA's example.

Finally, a major reason this Committee and its House counterpart have standing committee status rather than being a "select" committee is because of their SBA oversight and authorizing responsibilities. If SBA is abolished or its programs are transferred, there is little reason for this Committee to continue to exist. Small business knows who our champions are in Congress. We know who was responsible for the further graduation of the corporate income tax rate in 1981, for enactment of the Prompt Payment Act, for enactment of the Competition in Contracting Act in 1984, for the White House Conference on Small Business legislation, and innumberable other laws benefitting small business. These bills are a result of your efforts, Mr. Chairman, and the efforts of your colleagues on the Committee. We have no intention of losing our political voice in Congress by seeing SBA abolished and the power or jurisdiction of this Committee trimmed.

If I may, I would now like to briefly review the arguments OMB makes in support of the Administration's proposal. Contrary to reducing the deficit the Administration's proposal may well increase the deficit. For instance, the proposal suggests selling $12.054 billion of SBA's loan portfolio for an average of 19.3 cents on the dollar. Their proposal generates $2.316 billion of revenue over a four year period. SBA historically collects at least 80 cents on each dollar loaned and would thus expect to recover over $9.6 billion in loan repayments. By selling the portfolio, the federal deficit would be increased by $7.3 billion over the life of the portfolio. Such a proposal is ludicrous.

Numerous other specious numbers and fictitious statements are used to support the Administration's proposal. Here are some of them.

Administration fiction: "Most small businesses get along fine without SBA assistance or credit subsidies: *Less than 0.2% get SBA loans, *Less than 2% of new business are aided by SBA."

Fact: As previously stated, the GAO report belies the administration's position. To again quote the report:

> "The Administration is correct in stating that less than one percent of the roughly 11 million small businesses are assisted in any year by an SBA-guaranteed loan. However, in our opinion a more meaningful assessment of the program's value is to

compare the number of small businesses needing long-term financing and how much of this financing is provided through SBA-guaranteed loans. Unfortunately, data is not available on the number of small businesses that need long-term credit in any given year, but it is certainly much less than 11 million small businesses. In fact, Dun and Bradstreet's September 1979 market identifier record shows that only about 4.5 million firms had applied for credit at some time in their history."

GAO goes on to say that they estimate that the 30 to 40 percent of banks' longer-term financing that carries that an SBA guarantee "is a measure of the value of the SBA guarantee program that contrast with the Administration's statement that less than one percent of small businesses are served by the program."

Administration fiction: "The surge of private venture capital due to tax reforms and incentives is far more appropriate and effective course of small business investment funds."

Fact: First, Treasury in its tax proposal proposes to abolish the capital gains tax differential, the very incentive which has been responsible for the increase in available venture capital funds.

Second, venture capitalists expect an exceedingly high rate of return on their investment, a return that cannot be expected of your corner pharmacy, or local restaurant or service station. Venture capital requires equity participation and serves a unique, narrow, but very imporant niche of the business community.

Finally, according to the Venture Capital Journal, there was $2.8 billion of venture capital financing in 1983. Fewer than 1,000 firms received such equity funding that year. And a critical distinction is that equity funding is not a substitute for debt financing.

Administration fiction: "SBA loan subsidies go mostly to economic strap hangers--weak businesses who get repeated SBA loans.

* 53% of 1982 SBA borrowers were repeat customers; and

* 77% of 1983 (first half) SBA borrowers were repeat customers."

Fact: According to SBA records, the statistics are wrong. The percentage of SBA borrowers that had previously received assistance was 16.4% in Fy 1983; 13% in 1984; and 14.5% in the first quarter of 1985. And, since when are Nike Shoes, Apple Computer, Cray Research, Federal Express, Winnebago, Healthdyne, Intel, or Liquid Paper economic strap hangers? All these companies were the recipients of SBA financial assistance.

Administration fiction: "Default rates are exceedingly high. On guarantees made in the recent past, default rates to date are 1979, 19%; 1980, 23%; 1981, 19%."

Fact: According to SBA records the actual loss experience for all agency credit programs is 5.72 percent.

The point is Mr. Chairman, if there are to be discussions about SBA and its programs, we should play on a level playing field with facts, not fiction or misrepresentations.

This country 's ability to create jobs and new business opportunities has made the U.S. the envy of the world. During 1983, over 600,000 small businesses were formed. The country is in an entrepreneurial wave unmatched from any other country on earth. In the last decade, while Western Europe lost 2 million jobs, the U.S. created 20 million.

The total number of jobs in this country has risen 50 percent since 1965 from 71 to 105 million today, most of which came through small businesses. Through the years, the agency has meant the difference between success and failure for thousands and thousands of these small businesses. It is an agency which deserves your unqualified and enthusiastic support.

Senator Bumpers. Mr. Roller, thank you very much.

The next testimony is from Mr. Shattuck, executive director, Small Business Association of New England.

Mr. Shattuck.

Mr. SHATTUCK. I am just accompanying Mr. Roller. I will be glad to answer questions afterwards with the other witnesses.

Senator BUMPERS. Thank you very much.

Mr. Galanty, is that correct?

Mr. GALANTY. You got it right, sir. Thank you very much.

STATEMENT OF WALTER E. GALANTY, JR., CHAIRMAN, SMALL BUSINESS LEGISLATIVE COUNCIL

Mr. GALANTY. My name is Walt Galanty, and I am the chairman of the Small Business Legislative Council, which is a coalition of 89 trade associations representing over 4 million small businesses throughout the United States.

In January of this year, SBLC held an issues conference to develop our 1985 agenda. The matter of the SBA ended up to be our second priority, right after our tax policy, so we are very concerned about the SBA and the continuation of it.

Although we cannot give our unequivocal support of S. 408 because we are constrained by recommendations made by our committee as to the loan program, what we would like to do is recommend cutting the budget authority of the SBA by $250 million, which would come out to an approximate 35 percent across-the-board cut.

We cannot, quite frankly, get into an argument regarding whether to keep specific programs or whether to outlaw specific programs. We just want to come to you with the suggestion to say, let's cut the budget authority by $250 million if deficit reduction is the key—and we think that that is really the key—and, as I said before, that amounts to 35 percent of the $725 million proposed in the 1985 budget.

In 1981, we were one of the people who came and recommended a 27-percent cut in the program authority of the SBA, and at that time, those cuts exceeded the percent of cuts made in other agencies. We are prepared again to go out front with this $250 million authority in the SBA budget.

The last Congress, led by this committee, established the 1985-86 White House Conference on Small Business. The primary goal of that conference should be to evaluate the mission of the agency. I have not found a small business owner yet, and neither have our constituents, in the 4 million people out there, that has not been able to come up before this committee and really kind of tell it like it is.

The Conference, we think, is a logical vehicle to accomplish the task of reviewing the SBA programs. For these reasons, we are not quick to say eliminate this one and keep that one. We advocate a general across-the-board cut. We are realistic and flexible enough to go along with some adjustments made here and there according to the consensus.

As was mentioned in the previous panel, the SBA has been more successful than its detractors would conceive. Certainly, the SBIC and the MESBIC programs fulfill important functions as catalysts for job creation; likewise, the 503 development program and the guaranteed lending program.

I don't want to engage in a numbers game because you have been exposed to that. Mr. Stockman has numbers. Other people today and on previous days have had specific numbers. There are many ways, we think, to measure the size of small business constituency.

But it would be misleading to measure the value of the SBA, we think, strictly in terms of numbers, because of businesses that have received loans or management assistance. I think we have to deal with a much broader issue which really, I think, has not been dealt with in very succinct terms.

If the universe is to be defined as those firms which take advantage of the SBA instead of the huge number of businesses in existence, then the numbers, I think, reflect a positive benefit. However, this should not be the exclusive battleground for this debate. There is a much better and larger consideration which comes into play, and that consideration is not really very well quantified.

What the SBA represents as a national forum cannot be lost in the shuffle. The SBA, with the help of this committee and the committee on the other side, has made important inroads for small business in national policy discussions. Without these committees and the SBA, we could never have secured passage of landmark legislation such as regulatory reform, equal access to justice, recent procurement reform legislation, and many other small business laws.

Furthermore, such laws are often only as good as their oversight. The SBA and the congressional Small Business Committees play valuable roles in fulfilling this important function.

It is silly to think, in a budget consideration, if you say, well, we are going to keep advocacy, we are going to keep 503, and we are going to shuffle them off, that it is still going to cost money in the total to keep those funds and to keep those programs operating.

The SBA and small business throughout this country, the 14 million businesses, deserve a forum and a voice for small business. It is part of a delicately woven fabric that constitutes a mechanism by which small business is assured a voice in national policy decisions.

We hail the Office of Advocacy, and we hail your bill to get us on a discussion point to continue the SBA.

[The prepared statement of Mr. Galanty follows:]

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National Tooling & Machining Association

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Manufacturers Agents National Association

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Florists' Transworld Delivery Association

H. Ted Olson
Specialty Advertising Association International

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American Association of Minority Enterprise Small Business Investment Companies

SECRETARY
James M. Goldberg
Furniture Rental Association of America

TREASURER
Wayne J. Smith
United Bus Owners of America

PAST CHAIRMAN
Jared O. Blum
Direct Selling Association

EXECUTIVE DIRECTOR
Herbert Liebenson
National Small Business Association

STATEMENT
OF
WALTER E. GALANTY, JR.
CHAIRMAN
SMALL BUSINESS LEGISLATIVE COUNCIL

BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

MARCH 7TH, 1985

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DR. T. PETER RUANE
National Moving & Storage Association

JOHN SATAGAJ
American Association of Nurserymen

WAYNE J. SMITH
United Bus Owners of America

WALTER STULTS
National Association of Small Business Investment Companies

GIL THURM
National Association of Realtors®

J. RICHARD TROLL
Association of Independent Corrugated Converters

THOMAS ZAUCHA
National Grocers Association

We appreciate this opportunity to appear before the Committee on Small Business on the subject of the reauthorization of the U.S. Small Business Administration. My name is Walter E. Galanty, Jr. and I am Chairman of the Small Business Legislative Council (SBLC). SBLC counts among its members, 89 associations representing over 4 million small business owners, manufacturers, retailers, service firms and agriculture. In January of this year SBLC held an Issues Conference to develop our 1985 agenda. The conference adopted a strong policy position in support of the SBA. A copy is attached to this statement.

Eliminating the Small Business Administration is absolutely inconsistant with the fundamental economic goals of the Reagan Administration. SBA programs have played a pivotal role in leveraging new job opportunities which have generated billions of dollars in revenue for the Treasury.

Mr. Chairman, let me get right to the point. The issue here is deficit reduction and we have a proposal - cut the budget authority of the SBA by $250 million, which works out to an approximately 35% cut over this year's estimated 1985 operating authority of $725 million as reported in the President's Budget. If we could obtain similar cuts in all other Federal programs we would truly have a deficit reduction program. The issue here today should not be the elimination of a vital and important agency. Let me expand upon our proposal.

Small business has been a persistent and loud voice for deficit reduction. We understand its impact on the economy all too well. While interest rates have come down from the dizzying heights of a few short years ago, the current rate is by no means a bargain. The government's appetite for borrowed funds is enormous and our burgeoning deficits have had a dramatic effect on the availability of affordable credit. The economy, by most indicators, is healthy at the present time. It is the future we fear, if the deficits are not brought under control. Therefore, budget reduction is the number one priority of the small business community.

In 1981, we supported a 27% plus cut in the program authority of the SBA. At the time, these cuts exceeded the percent of cuts made in other agencies. We are prepared to go to the front of the line again, and for starters that is why we have offered a $250 million reduction in the SBA budget. We believe if you ask any small business owners on the street, they are going to say, "Just stop the spending, I don't care how." Freeze plus, freeze minus and the rest of the Washington terminology are just that — words. SBLC policy has been to advocate an across the board freeze on all programs, military as well as social security.

As you know, the current total budget authority of the SBA is roughly $700 million plus. The Stockman proposal would eliminate the agency. Some functions such as the minority programs and advocacy are transferred to the Department of Commerce. In the first years following termination, a liquidation unit is retained in the Department of Treasury to close out the loan programs. Therefore, elimination will not even net the current full $700 million plus budget of the SBA. The proposal includes the sale of the SBA loan portfolio which will likely yield over a period of years 19 cents on the dollar. While defaults of SBA loans have always been a controversial issue, the agency's track record in collection has improved dramatically, and allowing the process to run its course will certainly yield more revenue than the projected 19 cents on the dollar even when discounted to current values. We find it very difficult to understand why OMB would make such an effort to obtain a modest amount of revenue.

Our proposal will yield a solid $250 million. It is not a fancy proposal but it does get right to the point. On the numbers it is not far from the Weiker-Bumpers reauthorization proposal. We are playing in the same ballpark.

We cannot support elimination of the Small Business Administration. In the case of the SBA, the whole is greater than the sum of the parts. A review of all the SBA programs is justified and we would gladly cooperate in any effort to do so. We do not believe, however, that the urgent need to control the deficit lends itself to that process. Let's make the cuts first and then we can sit down and look at the future of the agency.

The last Congress, led by this committee, established a 1985-1986 White House Conference on Small Business. A primary goal of the Conference should be to evaluate the mission of the agency. I haven't found a small business owner yet who was afraid to tell it like it is. The Conference is the logical vehicle to accomplish the task of reviewing the specific SBA programs. For these reasons, we are not quick to say "eliminate this one, save that one." We advocate a general across the board cut in agency programs. We are realistic and flexible enough to be willing to go along with some adjustments here and there according to consensus.

In this process we cannot lose sight of the total picture. The SBA programs are many and diverse, but we do think it is a mistake to suggest there is no rhyme or reason to them. For many individual firms and industries, the government is an amalgamation of many small programs designed to meet the many diverse needs of the economy which cannot be met elsewhere. The SBA has been more successful than its detractors would concede. Certainly, the SBIC and MESBIC programs fulfill important functions as catalysts for job creation. Likewise the 503 development company program and the guaranteed lending program are marvelous outstanding examples of public/private sector cooperation in economic develpment. The SBDC management program and the procurement programs are just gathering steam and and demonstrating solid results. These programs do mean a lot to the small business community. The aggregate constitutes a significant contribution to a stronger and healthier economy.

We do not want to engage in a numbers game. There are many ways to measure the size of the small business constituency but it would be misleading to measure the value of the SBA strictly in terms of the number of businesses that have received a loan, or management assistance. However, if the universe is defined as those substantial firms which would be likely to take advantage of SBA programs, instead of the huge number of all small businesses in existence, then the numbers reflect a positive benefit. However, that should not be the exclusive battleground for this debate. There is a much more important consideration which comes into play. This consideration is not so easily quantified. What the SBA represents as a national forum cannot be lost in the shuffle. The SBA, with the help of the Senate and House Small Business Committees, has made important in-roads for small business in national policy discussions. Without the committees and the SBA, we could never have secured passage of landmark legislation such as the Regulatory Flexibility Act, the Equal Access to Justice Act, recent procurement reform legislation or the several other major small business laws. Furthermore, such laws are often only as good as their oversight. The SBA and the Congressional Small Business Committees play valuable roles in fulfilling this important function.

The SBA assists many small businesses which do not show up in the statistics, and frequently do not even belong to national associations. Certainly, the associations will continue to represent the interests of these small firms. But I do not know anyone in the small business community who claims it could be done without the SBA or the Senate and House Small Business Committees. The SBA does serve as a forum, and a voice, for small business. It is part of a delicately woven fabric that constitutes the mechanism by which small business is assured a voice in national policy decisions. We all hail the value of the Office of Advocacy. The SBA in its entirety is an advocate for small business. Whether it is a procurement break out specialist or someone managing a 503 development package, the agency is promoting and fostering a strong small businesss community which leads to more jobs and a healthy economy.

The authority and independence that Congress vested in the Office of the Chief Counsel for Advocacy has proved critical in what that office has accomplished on behalf of small business in the Executive Branch. It allows small business to participate in national policy decisions that affect it, a prerogative it would not otherwise enjoy. It is imperative that small business retain that lifeline.

It has been suggested that these advocacy functions be retained and transferred to the Department of Commerce. We do not believe for one minute this transfer will result in the retaining of even the smallest fraction of the influence the SBA now has in shaping the future of small business.

Small Business is a first class contributor to the economy, job creation and innovation. We'll take the lead and shoulder more than our fair share of budget cuts, if that's what's needed to get the deficit reduciton ball rolling. But do not relegate us to fourth class status in a mammoth bureaucracy. We fully support an independent and strong SBA for an independent and strong small business community. Thank you.

SMALL BUSINESS LEGISLATIVE COUNCIL

PRIORITY NUMBER 2

THE SMALL BUSINESS ADMINISTRATION

The Small Business Administration (SBA) was formed under a broad general mandate to protect and promote the interests of small business in the American economy. For more than 30 years, SBA has stood as the sole government advocate for the small business community.

RESOLUTION:

SBLC strongly opposes the Administration's proposal to eliminate the Small Business Administration. SBLC believes it would be a tragic mistake to kill the single agency which represents the interests of small business in the Federal government. Because small business creates the vast majority of new jobs and product innovations in the U.S. economy, pays substantial taxes to the Treasury and produces almost one-half of the nation's gross national product, it is absolutely essential that the SBA continue to represent the small business community in the executive branch of government.

SBLC supports the basic mission and the continuation of the Small Business Administration. The SBA must maintain its status as an autonomous agency whose sole mission should be to advocate for and assist the small business community, with the private sector having a stronger partnership role.

To ensure that SBA's mission remains focused on areas of greatest need:

1. The independent role of the Office of Advocacy must be maintained and strengthened.
2. Congress should mandate a comprehensive review of all SBA programs to assess their efficiency and their appropriateness to the broad needs of the small business community. That review should be conducted under the direction of the private sector, with the leadership of the small business constituency.
3. In the delivery of lending and management assistance services, SBA should be directed to increase its reliance on the local resources in the private business sector which have expertise in its program areas. SBA lending programs remain a vital resource for small business, and they must be maintained.
4. To increase small business's role in policy-making, the SBA Administrator should be a member of all Cabinet Councils affecting commerce, trade and the economy.
5. The SBA, whether through program divisions, local resources or the Office of Advocacy must expand its efforts to disseminate vital information (particularly on government regulatory efforts) to small business and provide not only management, but also technical assistance necessary for understanding and complying with such requirements.

Senator BUMPERS. Thank you very much, Mr. Galanty.

Mr. Donley.

STATEMENT OF THOMAS E. DONLEY, DIRECTOR, SMALL BUSINESS CENTER, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. DONLEY. Thank you, Mr. Chairman.

I can see that we are in good company today, and I am pleased to see that there is more or less a united front on the part of small business organizations representing their members.

I want to applaud Brad Roller's support for the guaranteed loan program, Walt Galanty's recommendation that the White House Conference be a forum on small business and some of his other comments.

I am here in substitution for the chairman of our Small Business Council today, David Weatherup, a businessman from Syracuse, NY, who sends his regrets. With the rescheduling of the testimony due to Mr. Stockman's illness, he wasn't the only person who was inconvenienced by that situation, and Mr. Weatherup, who had wanted to be here on February 25, was unable to be here today.

I am the director of the Small Business Center at the U.S. Chamber of Commerce, and I am here today with Mark Shultz, who is the manager of the Business-Government Policy Department at the chamber.

I have been with the chamber since last April, and before that, for 4 years, I was on the staff of the Greater Philadelphia Chamber of Commerce, representing the interests of retailers in Philadelphia. I say that only because my experience working with retailers gave me some insights into their financing and management assistance needs and into the interrelationships among the business community and the local SBA and a local chamber of commerce.

I would like to summarize the chamber's position on Senate bill 408 in roughly three points. We also have written testimony that provides our position in more detail.

First, the chamber is committed to a strong, independent SBA, and accordingly, we support Senate bill 408. We are prepared to accept, second, significant cuts in SBA funding as part of a comprehensive Federal budget restraint.

But also, and third, the SBA must be refocused and restructured to provide more effective representative of, and services to, small businesses.

Here is why we support a strong, independent SBA. I think some of the others have made similar points. Having an independent agency headed by an administrator who is a member of the President's Cabinet Council on Commerce and Trade is vitally important to small business. It gives them clout.

Also, the SBA's Office of Advocacy, with its unique advocacy role, would not be able to have the impact and independence as a subunit of the Department of Commerce.

Third, as Walt said earlier, having the Small Business Committees in both Houses of Congress with oversight and investigative authority over the SBA and over small business issues, generally, is very important in developing national policies which help small and growing businesses.

However, we don't think Senate bill 408 goes far enough in calling for a refocused and restructured SBA, in view of the current budget problems and the continuing growth in Federal spending.

We support a freeze of SBA spending. We support additional savings through elimination of the direct loan programs and adjustments in the loan guarantee programs that will bring in more revenues; also, further cuts of economically inefficient programs that the SBA is running now.

As for the loan guarantee programs, they have served, and continue to serve, a vital role in filling an institutional gap in private sector financing for small businesses.

I am sure you are familiar with the GAO study and other facts and figures that have supported the guarantee programs which refute David Stockman's facts, and I think that it is up to the supporters of small businesses to keep making that case, that through the SBA's guarantee programs, at least, small businesses have gotten from 30 to 40 percent of their long-term financing from commercial banks.

We urge continuation of these programs, as well as the 503 certified development and the secondary market improvement programs. These are innovations that increase small business financing at very little cost to the Government.

We also support some of the, I will call them privatization activities that have taken place in the guaranteed lending area, the expansion of the preferred and certified lender programs, giving banks more delegated authority in doing credit analysis and in making loan commitments.

Under these preferred lender programs, which carry a lower guarantee than the current 90 percent guarantee that the SBA has, the agency could still target assistance to veterans, minorities, and the handicapped by allowing higher guarantees on loans made to business people in those conditions compared to other business people.

We also support recommendations to restructure the loan guarantee program to reduce costs to the taxpayer. Primarily, I am talking about charging a higher loan guarantee origination fee, which the vast majority of commercial banks in that GAO study said would not cause a reduction in their small business lending.

On disaster loans, we completely agree with the sponsors of the bill that the SBA should limit its assistance to businesses which have suffered from physical disasters.

Looking to the future, we urge that the SBA and this committee use the resources and leadership of the Federal Government to develop small business loan and equity financing through State and local government intermediaries and through the private sector, instead of trying to do everything on its own.

For example, we would like to see Federally regulated lending institutions, commercial banks, savings and loans—the main ones—to be able to establish venture capital funds to invest in small businesses, and we ask for your help and leadership in introducing legislation to this effect in this session.

In management assistance, we applaud the SBA's efforts to again transform the management assistance function from one of providing direct hands-on assistance to one of serving as coordinator of resources.

When the SBA serves as a catalyst rather than as a direct service provider, it unleashes the vast and diverse capacities of private and institutional interests to serve small business. Again, it cannot do it all with only about 4,200 full-time employees.

We would support a pilot project using State and local chambers of commerce as prime contractors to develop a private system of management assistance for small businesses.

We think the SBA should also phase out its funding support for small business development centers. If the SBDC's are important to the States, the States should be willing to pick up the Federal share and also be allowed to charge fees for the services to fund those centers.

Currently, in most cases, the recipients of services get those for free, and we think small business people are willing to pay reasonable fees for that help in helping them run their businesses more effectively.

In other areas, the SBA should continue its growing role in procurement assistance and the small business innovation research program. The SBIR program is coming under some resistance, I think, within the bureaucracy.

We have understood informally that some of the agencies are not meeting their commitments to get to over 1¼ percent grants in their research programs. I believe the program is up for reauthorization in about 2 years. We think it has been a tremendous program and should be continued.

Back to advocacy for just a second. I want to reemphasize the importance of the Office of Advocacy and its work in monitoring existing laws and regulations, forming a data base with small businesses, initiating research on small business problems, educating State and local policymakers, and promoting public awareness of the contributions of small business.

These functions, in addition to the watchdog role, really make it one of the most cost-effective activities that the Federal Government has provided, and I don't think they are going to be replaced or matched anywhere else.

To sum up, we urge that the bill go farther in streamlining the agency. End the direct loans, increase revenues from the loan guarantee programs, increase revenues from management assistance, and work on more private sector and State participation in these programs.

The White House Conference is the perfect opportunity to review these programs and to get small business' views and detail on SBA's future role in financing, management assistance, entrepreneurship, and restoring America's competitive edge.

The administration has jeopardized the success of this Conference by foot-dragging, and we have been urging our members to contact the White House to get planning started again. We strongly urge you and the committee to do all that you can to assure that the administration authorizes the SBA to proceed with planning for the conference.

We think the SBA can continue its critically important work at about a third of its current operating budget of $700 million. Savings beyond that will come from the continuing servicing of the loan portfolio that the agency has, and additional savings can come from the procurement programs, last year estimated to have saved the Federal Government over $200 million a year.

Our proposals, we think, offer a better way, and we urge the committee to adopt them.

[The prepared statement of Mr. Donley follows:]

LET'S REBUILD, AMERICA
IN THE 80's

Statement of the Chamber of Commerce of the United States

ON: SMALL BUSINESS ADMINISTRATION'S FUNDING AND PROGRAMS FOR FISCAL YEARS 1986, 1987, AND 1988

TO: SENATE SMALL BUSINESS COMMITTEE

BY: THOMAS E. DONLEY

DATE: MARCH 7, 1985

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The Chamber of Commerce of the United States is the world's largest federation of companies and associations, and is the principal spokesman for the American business community. It represents more than 180,000 companies plus several thousand other organizations such as local/state chambers of commerce and trade/professional associations.

More than 85 percent of the Chamber's members are small firms with fewer than 100 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business — manufacturing, retailing, services, construction, wholesaling, and finance — numbers more than 14,000 members. Yet, no one group constitutes as much as 26 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 50 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services, and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
SMALL BUSINESS ADMINISTRATION'S FUNDING AND PROGRAMS
FOR FISCAL YEARS 1986, 1987, AND 1988
before the
SENATE SMALL BUSINESS COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
THOMAS E. DONLEY
March 7, 1985

SUMMARY

1. The U.S. Chamber of Commerce (U.S. Chamber) is committed to a strong, independent Small Business Administration (SBA) agency representing small business interests in national policy formulation and providing and promoting services for small businesses.
2. The U.S. Chamber is prepared to accept significant cuts in SBA funding as part of a comprehensive federal budget restraint to slow the growth in federal spending and reduce the federal deficit without tax increases.
3. The SBA must be refocused and restructured to provide more effective representation of and services to small businesses in financing, management assistance, procurement, advocacy, and leveraging of state government and private sector resources for small businesses.

FISCAL YEAR 1986 BUDGET RESTRAINT

The U.S. Chamber supports the President's objective of reducing the deficit from about five percent of the gross national product (GNP) to four percent of GNP in 1986, three percent of GNP in 1987, and two percent of GNP in 1988. Deficit reduction should come through spending restraint, not tax increases.

As a start, the federal budget should be frozen for 1986 at this year's level to the greatest extent possible. Of course, some parts of the budget, including interest payments on the national debt, cannot be frozen. Therefore, an overall freeze can be achieved only through significant reductions in many discretionary spending programs.

None of these programs -- including those important to business -- should be excluded from consideration for major cutbacks. We endorse significant reductions in SBA funding provided those cuts are part of a comprehensive, far-reaching effort to diminish spending.

STRONG, INDEPENDENT SBA REPRESENTING SMALL BUSINESS INTERESTS

We do not agree with President Reagan's proposal to eliminate the SBA. However, the SBA can absorb major budget reductions and remain a strong, independent agency.

Under the President's proposal, SBA's credit programs would be abolished. The agency's outstanding loans would be transferred to the Treasury Department and liquidated within four years, and a new Administration for Enterprise Development and Opportunity would be created within the Commerce Department, managing many of SBA's current programs.

If you look at the proposal carefully and study the numbers, you will find that it is not a significant budget-reduction proposal at all! In fact, it has been estimated that the shutdown of SBA and the sale of its loans would cost the taxpayers as much in lost loan repayments as in proposed savings.

In the opinion of the small business community, having an independent small business administration headed by an administrator who is a member of the President's Cabinet Council on Commerce and Trade is vitally important.

Also the SBA's Office of Advocacy, with its statutory mandate and license to represent small business independent of the Administration's point of view, would lose its unique advocacy role if it became a sub-unit of an Executive Branch agency.

Despite our disagreement with the President on the specific approach toward reorganizing SBA's programs, we strongly believe his effort to force the small business community and the Congress to develop a plan to restructure the agency is in the nation's and agency's best interests.

REFOCUSED AND RESTRUCTURED SBA

We support a freeze of SBA spending; additional savings through elimination of the direct loan program and adjustments in the loan guarantee program; and further cuts of economically inefficient programs and of programs that do not meet critical national needs. We think that the best way to examine SBA programs for additional cuts would be within the framework of the 1986 White House Conference on Small Business.

During this evaluation, the Congress and the business community should not be wedded to the SBA in its current form and should be willing to explore program shifts within the federal government, from the federal to the state government, and from the federal government to the private sector.

S. 408 is a good first step but does not go far enough in removing the SBA from the direct lending business and in restructuring the agency. The U.S. Chamber, and, we believe most others who represent small business, believe strongly that the direct loan programs should be ended in 1986.

LOAN GUARANTEE/DISASTER LOAN PROGRAMS

The general business loan guarantee program has served and continues to serve a vital role in filling an institutional gap in private sector financing for small businesses.

A 1983 General Accounting Office survey of commercial lenders found that the vast majority would not be making long-term loans (over five years) to small businesses without the federal guarantee. Few businesses can survive on short-term loans at above-market interest rates, as would be the case without the guarantee. At the same time, a majority of the banks indicated that their participation in the program would not be affected if the SBA reduced the guarantee from 90 percent to 80 percent.

Recognizing the importance of the loan guarantee and the need to improve its operations, Congress enacted P.L. 96-302, the "Certified Development Company Program," in 1980 and P.L. 98-352, the "Secondary Market Improvement Law," in 1984.

The Certified Development Company law has increased the amount of long-term financing available for capital improvements by allowing up to 40 percent of project financing to be guaranteed by an SBA loan. The Secondary Market law allows the SBA to leverage its guarantee money by selling its guaranteed loans to major institutional investors and recycling the proceeds from those sales into new guarantees.

We urge the continuation of these innovative programs and the expansion of the Certified Lender and Preferred Lender programs recently instituted by the SBA.

The "Lender" programs trim administrative costs by placing responsibility for loan application analysis with private lending institutions rather than with the SBA personnel. This not only cuts SBA's personnel costs, but it also results in a higher quality portfolio since the analysis is performed by a skilled professional familiar with local conditions. Also, the Preferred Lender program reduces SBA exposure on loans to only 70 percent, rather than the current 90 percent guarantee. And finally, both programs assure a quick decision for the loan applicant.

With the elimination of the targeted direct loan program, the SBA still could target its assistance to veterans, minorities, and the handicapped by allowing a higher guarantee on loans made to business people in those categories. However, the federal government cannot and should not attempt to guarantee business success. After initial assistance, loan beneficiaries must be treated just like other businesses, to succeed or fail on their own.

Furthermore, we support recommendations to restructure the loan guarantee program so that it reduces costs to the taxpayer. This could be achieved by raising the fee charged for loan guarantee origination.

On the subject of disaster loans, we completely agree with Chairman Weicker and the other sponsors of S. 408 that SBA should limit its assistance to businesses which have suffered "physical" disasters. SBA's effectiveness has been diminished by making disaster loans to individuals, farmers, and to businesses suffering from "nonphysical disasters."

We recommend that the SBA use the resources and leadership of the federal government to develop small business loan and equity financing through state and local government intermediaries and through the private sector. We urge this Committee to focus its attention on new ideas in this area, such as

- privatizing of Small Business Investment Company financing through the creation of the Corporation for Small Business Investment;
- allowing federally regulated lending institutions to establish venture capital pools to invest in small businesses; and,
- directing SBA to work with existing private sector organizations, including state and local chambers of commerce, the National Development Council, National Association of Development Companies, National Association of Small Business Investment Companies, and the American Association of Minority Enterprise Small Business Investment Companies, to encourage states to provide and develop small business financing.

MANAGEMENT ASSISTANCE, PROCUREMENT ASSISTANCE, INNOVATION RESEARCH, OTHER SPECIAL PROGRAMS

The Chamber applauds SBA efforts to transform the management assistance function from one of providing direct, hands-on assistance to one of serving as coordinator of resources. Through the Service Corps of Retired Executives, Small Business Resource Centers in local chambers of commerce, and similar approaches, SBA has demonstrated that it can multiply its own budgetary resources. When SBA becomes a catalyst in cooperative efforts, it helps to unleash the vast and diverse capacities of private and institutional interests to serve small business. Thus, it not only leverages its own efforts but helps to generate a more effective total support system for small business.

The SBA should be using the private sector to help perform the educational functions it is still providing on its own. This could include contracting out of seminars, conferences, and management services. For example, the SBA could begin phasing out its funding support for Small Business Development Centers, with lost revenue to be replaced with an increased state share of funding and increased fees for services.

The SBA should continue its growing role in procurement assistance and the Small Business Innovation Research (SBIR) program. Despite bureaucratic objections to these programs, they have stimulated competition in government purchasing and have tapped small businesses' tremendous capabilities in research and development for government programs. The cost savings far outweigh the minor administrative costs. In fact, the SBIR program could serve as a model to address private sector shortcomings, such as management assistance for women and minorities and small business export development.

We think that the 1986 White House Conference on Small Business would be the perfect forum to review these programs in greater detail and to develop recommendations on the SBA's role in management assistance from small business people across the nation. The Administration has jeopardized the success of this Conference by delaying its planning. We strongly urge this Committee to do all that it can to assure that the Administration authorizes the SBA to proceed with planning for the Conference.

ADVOCACY

The Office of Advocacy is extremely important as an Administration watchdog to raise small business concerns regarding proposed legislation and regulations. Also, its work in monitoring existing laws and regulations, forming a data base, initiating research on small business problems, educating state and local policymakers, and promoting public awareness of the contributions of small business is one of the most cost-effective activities in the government.

CONCLUSION

Our proposals would cut agency operating expenses by more than 60 percent in FY 1986, more than the President's proposal would achieve, and more than S. 408 would accomplish, by:

- ending the direct loan program;
- increasing revenues from the loan guarantee program while reducing the levels of most of the guarantees;
- working to increase private sector and state financing of both debt and equity;
- working to increase revenues from management assistance programs and to increase private sector and state participation in these programs; and,
- continuing at present levels the procurement assistance, SBIR, and Office of Advocacy programs and initiating new programs based on the SBIR model.

The SBA can continue its critically important work at roughly one-third of its current operating budget of about $700 million in 1985. Additional savings will come from the orderly debt service on the agency's loans and the more than $200 million per year in budget savings from the agency's procurement activities. Our proposals offer a better way, and we urge this Committee to adopt them.

Senator BUMPERS. Thank you very much, Mr. Donley.

Mr. Doyle.

STATEMENT OF FRANCIS X. DOYLE, DIRECTOR, GOVERNMENT AFFAIRS, SMALL BUSINESS SERVICE BUREAU, INC.

Mr. DOYLE. Good morning, Senator Bumpers.

I was very glad this morning to see our Massachusetts Senator as a new member of our committee and to continue our tradition here in the Senate Small Business Committee.

I am very happy to come here today to support the positive efforts that are going on in the committee here to keep the SBA in business.

I found the testimony of David Stockman last week to be the most ominous opposition to SBA that I have ever heard. We agree that the job of cutting the Federal deficit and Federal spending is a very crucial one, but the interchange that I witnessed between David Stockman and this committee last week I thought was very alarming.

Today I am here to bring you the testimony on behalf of our 35,000 members from across the country, and if Mr. Stockman knew that 76 percent of them voted for the President, he might have been a little more kind to the committee.

When we heard that William Baxter said, "There is nothing written in the sky that says the world would not be a perfectly satisfactory place if there were only 100 companies," it became clear that anything but big business would be persona non grata in this administration.

Now we have the OMB director cutting the SBA and the Secretary of Commerce proposing to repeal the Clayton and Sherman Acts. What better way to hurt small business than to allow return to what we feel is a merger mania at the same time as removing a prime source of long-term capital for entrepreneurs?

In his remarks to you last week, Senator, Stockman kept referring to the fact that unless some market defect exists, there was no need for the SBA. We would argue, Senator, that the administration's support of bank deregulation is creating that market defect.

As banks have merged and crossed industry lines into more profitable ones, they would rather make one $200,000 loan to a larger company than to bother to help 10 small businesses with a mere $20,000 each.

Senator BUMPERS. Mr. Doyle, I want to interrupt you to tell you that is one of the best points that has been made since we started these hearings.

Go ahead.

Mr. DOYLE. Thank you.

I couldn't help but get angry when he was going back and forth with you, and I think that their policies are exacerbating the problem. Our members are currently paying 3 percent above the prime rate for their loans. The average loan is strictly about $20,000, not a lot of money.

The argument on the number of small businesses, also, if you look at the fact that 98 percent of the country's businesses have under 100 employees, the President and the SBA admit this is where the jobs are coming from, this is where the innovations are coming from; but he is not willing to admit that SBA has been a real difference for small businesses, perhaps only during part of their life in business so far, but it has been a very important part in keeping them in business and allowing them to grow.

We are not asking that SBA be exempt from budget cuts that are necessary to reduce the deficit. We acknowledge that SBA has had its problems over the years, but we feel that the economic interests of the Nation can be better served by redirecting and restructuring SBA instead of outright abolishment.

SBA was cut by 25 percent back in 1980, but instead of proportionately reducing its activities and helping the truly small business, the agency is trying to serve more and larger firms. We feel the SBA should scale down its size standards to serve the truly small firms with 100 or less employees, again where the job generation and innovation are occurring.

The SBA seems to have abrogated their primary function to the banks in their loan program and the colleges in their management assistance program. We feel the SBA should put its money where there is the best return, by organizing programs that have been around for quite a while such as SCORE, but that the services offered by the SBDC's are duplicating those offered in many parts of the private sector.

We feel that the SBDC funding has quickly headed toward $50 million, which has gone for an increasing percentage of the SBA's budget in their management assistance function.

If you look at the Agriculture Department that has approximately a $40 billion budget, that works out to about $17,000 for every farm in the country. How can the administration argue in good conscience to scrap the SBA, the only program helping small businesses, when this amount of money is being spent on every farm—and I know that you have been hearing from the farmers very consistently.

Senator BUMPERS. Mr. Doyle, before I forget it, let me clarify that, because I don't want the record to reflect that.

When you talk about the $45 billion in the Department of Agriculture, that represents about 4.7 percent of the budget. Actually, the farm programs only represent about 1.4 or 1.5 percent of that. The rest of that is in food stamps and in nutrition programs for children, administration, and a whole host of things.

So to divide the number of farmers into $45 billion and say there is $17,000 in there for each farmer is not quite accurate.

Mr. DOYLE. I am just trying to make the point that there has to be an equal addressing——

Senator BUMPERS. I understand your point, and it is well taken.

Mr. DOYLE. All right, thank you.

When Mr. Stockman said that there is no room in the administration for public intervention in the financial marketplace, it seems to me that the fair budget constraint itself, though, has gone out the window in favor of political clout or depending upon their direction in a given week.

Large businesses, we feel, get enough help from the Government through industrial revenue bonds and export-import bank loans. The SBA must stop trying to be all things to all businesses and concentrate its energy on providing assistance to the truly small firms.

I think what really disturbed me the most, Senator, was the comments to Senator Levin by Mr. Stockman, that it really boiled down to he felt there was no need for SBA whatsoever, whether there was a deficit problem or not.

After listing to the debate on numbers, it was very clear that the administration would not do anything for small businesses, whether they were 4 million in number or 14 million in number.

The fundamental question boils down to, to what extent will the Federal Government provide assistance not just to small business but again to anyone? Is there a place for Federal assistance to start or finance your own business? We feel that this is much more prudent policy than some of the things we are doing. I will leave the agriculture expertise to you, Senator.

But, essentially, consistency is the problem we are seeing in public policy. SBA is to be eliminated for its intervention in the financial marketplace. How, then, can the Government justify an annual $2 billion to underwrite lower interest rates for large businesses that certainly can get credit on their own, through subsidizing interest rates on IDB's?

If the SBA is subsidizing interest rates, and I question that—the rates that are charged on SBA loans are definitely market rates—how can the administration help to create a real estate industry that is virtually tax exempt due to the complexity of the tax code?

If the SBA is not creating capital but, as the Wall Street Journal says, misallocating it to the least efficient users, why, then, do we allow over $120 billion in corporate mergers in a single year that absorb capital and concentrate power with no economic growth or new employment?

If the true argument today were the budget deficit, we feel that the SBA would be very low on the priority list. Small business owners themselves can understand a cut in SBA funds and are willing to pay their fair share.

In that light, Senator, your bill, Senate bill 408, we feel, is a commendable step to retain an independent agency while providing a 30-some-odd-percent cut that shows a very responsible spending position.

If other agencies and committees would be so bold as to propose freezes in agencies and cuts in programs, we would be much closer to that $50 billion downpayment.

But to say that the SBA's budget should be eliminated, when its total annual budget would only run the Defense Department for about 5 hours, we feel is absurd. [Laughter.]

So we think the $661 million that you have come up with is a solid step, and we support that very much.

Thank you, Senator.

[The prepared statement of Mr. Doyle follows:]

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TESTIMONY

OF

FRANCIS X. DOYLE

DIRECTOR, GOVERNMENT AFFAIRS

SMALL BUSINESS

SERVICE BUREAU, INC.

544 MAIN STREET

WORCESTER, MA

BEFORE THE U.S. SENATE

COMMITTEE ON SMALL BUSINESS

RELATIVE TO

SENATE 408 SBA AUTHORIZATION

A Big PLUS for small business success!

MR CHAIRMAN, I AM GLAD TO HAVE COME TO WASHINGTON THIS MORNING TO SUPPORT YOUR EFFORTS TO RENEW THE AUTHORIZATION FOR THE U.S. SMALL BUSINESS ADMINISTRATION.

THE TESTIMONY OF OMB DIRECTOR DAVID STOCKMAN WAS THE MOST OMINOUS OPPOSITION TO SBA I HAVE EVER HEARD. THE JOB OF CUTTING FEDERAL SPENDING AND THE DEFICIT IS A CRUCIAL ONE, BUT THE INTERCHANGE I WITNESSED BETWEEN THIS COMMITTEE AND MR. STOCKMAN WAS ALARMING.

TODAY, I AM HERE TO BRING YOU TESTIMONY ON BEHALF OF OUR 35,000 MEMBERS FROM ACROSS THE COUNTRY, 76% OF WHOM, MR. CHAIRMAN, SUPPORTED THE PRESIDENT IN HIS RE-ELECTION.

AFTER WILLIAM BAXTER SAID "THERE IS NOTHING WRITTEN IN THE SKY THAT SAYS THE WORLD WOULD NOT BE A PERFECTLY SATISFACTORY PLACE IF THERE WERE ONLY 100 COMPANIES", IT BECAME VERY CLEAR, THAT ANYTHING BUT BIG BUSINESS WOULD BE **PERSONA NON GRATA** IN THIS ADMINISTRATION. NOW WE HAVE THE OMB DIRECTOR CUTTING THE SBA AND THE SECRETARY OF COMMERCE PROPOSING TO REPEAL THE CLAYTON AND SHERMAN ACTS. WHAT BETTER WAY TO HURT SMALL BUSINESS THAN TO ALLOW A RETURN TO MERGER MANIA AT THE SAME TIME AS REMOVING A PRIME SORCE OF LONG TERM CAPITAL FOR ENTREPRENEURS.

IN HIS REMARKS TO THIS COMMITTEE LAST WEEK, STOCKMAN KEPT REFERRING TO THE FACT THAT UNLESS SOME MARKET DEFECT EXISTS, THERE WAS NO NEED FOR THE SBA. WE WOULD ARGUE, MR. CHAIRMAN, THAT THE ADMINISTRATION'S SUPPORT OF BANK DEREGULATION IS CREATING THAT MARKET DEFECT. AS BANKS HAVE MERGED AND CROSSED INDUSTRY LINES, THEY FIND IT

MORE PROFITABLE TO MAKE ONE $200,000 LOAN, THAN TO HELP TEN SMALL COMPANIES WITH A MERE $20,000 EACH.

EVEN NOW, THE BASIC FINANCIAL NEEDS OF MANY SMALL BUSINESSES, ARE NOT BEING ADEQUATELY MET. WHILE BIGGER BANKS ARE VYING WITH EACH OTHER TO ATTRACT MORE AFFLUENT CUSTOMERS, OTHERS HAVE TO PAY TOO MUCH FOR BASIC SERVICES. IN THE CASE OF A SMALL FIRM, IT MEANS BEING DENIED A LOAN, WHICH GOES TO LARGER, LESS FINANCIALLY STRAPPED COMPANIES.

OUR MEMBERS CURRENTLY PAY 3% OVER THE PRIME RATE FOR A LOAN. THE AVERAGE LOAN REQUIRED IS APPROXIMATELY $20,000. MOST BIGGER BANKS DON'T WANT TO BE BOTHERED WITH PROCESSING SUCH A SMALL LOAN, WHEN THEY CAN JUST AS EASILY PROCESS A $200,000 LOAN FOR A WEALTHIER CUSTOMER.

NINETY-EIGHT PERCENT OF AMERICA'S 7.4 MILLION BUSINESSES HAVE 100 OR LESS EMPLOYEES. BOTH PRESIDENT REAGAN AND THE SBA ADMIT THAT THESE BUSINESSES ARE RESPONSIBLE FOR CREATING MOST OF THE NEW JOBS AND INNOVATION IN THIS COUNTRY. THROUGH THE YEARS, THE SBA HAS MEANT THE DIFFERENCE BETWEEN SUCCESS AND FAILURE FOR THOUSANDS OF SMALL BUSINESSES.

WE ARE NOT ASKING THAT THE SBA BE EXEMPTED FROM BUDGET CUTS NECESSARY TO REDUCE THE SOARING FEDERAL DEFICIT. WHILE WE ACKNOWLEDGE THAT THE SBA HAS ITS PROBLEMS, THE ECONOMIC INTERESTS OF THE NATION CAN BE BETTER SERVED BY REDIRECTING AND RESTRUCTURING THE SBA, INSTEAD OF ABOLISHING IT.

THE SBA'S BUDGET WAS CUT TWENTY-FIVE PERCENT IN 1980, BUT INSTEAD OF PROPORTIONATELY REDUCING ITS ACTIVITIES TO HELP THE TRULY SMALL BUSINESS, THE AGENCY IS TRYING TO SERVE MORE AND LARGER FIRMS. THE SBA SHOULD SCALE DOWN ITS SIZE STANDARDS TO SERVE THE TRULY SMALL FIRMS WITH 100 OR LESS EMPLOYEES WHERE THE REAL JOB GENERATION AND INNOVATION ARE OCCURING IN THIS COUNTRY.

IF THE AGENCY DOESN'T HAVE THE FINANCIAL RESOURCES TO SERVE FIRMS OF 100 OR LESS, IT SHOULD FURTHER SCALE DOWN ITS STANDARDS TO SERVE THOSE WITH ONLY 50 EMPLOYEES OR LESS. ALSO, THE RECOMMENDATIONS OF THE GRACE COMMISSION IN REGARD TO THE SBA SHOULD BE STUDIED FOR ADDITIONAL SOURCES OF COST SAVINGS.

I FEEL THE SBA HAS ABROGATED ITS PRIMARY FUNCTION BY RELEGATING ITS LOAN PROGRAM TO THE BANKS AND ITS MANAGEMENT ASSISTANCE PROGRAM TO COLLEGES THROUGH THE SMALL BUSINESS DEVELOPMENT CENTERS. SBA SHOULD PUT ITS MONEY WHERE IT WILL GET THE BEST RETURN BY ORGANIZING EFFECTIVE PROGRAMS LIKE SCORE, THE SERVICE CORPS OF RETIRED EXECUTIVES. THE SERVICES OFFERED THROUGH SMALL BUSINESS DEVELOPMENT CENTERS ARE DUPLICATING SERVICES PROVIDED MORE EFFICIENTLY AND EFFECTIVELY BY THE PRIVATE SECTOR. SBDC FUNDING HAS QUICKLY HEADED TOWARD $50 MILLION, AN INCREASING PERCENTAGE OF SBA'S BUDGET.

IN 1983, THE AGRICULTURE DEPARTMENT HAD A BUDGET OF $40 BILLION. THIS WORKS OUT TO $17,000 SPENT ON EACH FARM IN AMERICA. HOW CAN THE ADMINISTRATION IN GOOD CONSCIENCE SCRAP THE SBA, THE ONLY PROGRAM TO HELP SMALL BUSINESS, WHEN SO MUCH IS BEING SPENT TO SUBSIDIZE FARMING?

DAVID STOCKMAN WAS QUOTED AS SAYING, "THERE IS NO ROOM IN THIS ADMINISTRATION FOR PUBLIC-SECTOR INTERVENTION IN THE FINANCIAL MARKETPLACE." HOW CAN THE PRESIDENT SUBMIT A ZERO BUDGET FOR OUR ONLY SMALL BUSINESS PROGRAM, WHILE HE IS CUTTING DEALS TO PROVIDE LOAN GUARANTEE INCREASES FOR OUR FARMS? IT SEEMS TO ME THAT FAIR BUDGET CONSTRAINT HAS GONE OUT THE WINDOW IN FAVOR OF POLITICAL CLOUT.

LARGE BUSINESSES GET ENOUGH HELP FROM THE GOVERNMENT THROUGH INDUSTRIAL REVENUE BONDS AND EXPORT-IMPORT BANK LOANS. THE SBA MUST STOP TRYING TO BE ALL THINGS TO ALL BUSINESSES AND CONCENTRATE ITS ENERGY ON PROVIDING ASSISTANCE TO THE NATION'S TRULY SMALL BUSINESSES.

WHAT DISTURBS ME MOST MR. CHAIRMAN, IS MR. STOCKMAN'S COMMENT TO SENATOR LEVIN, THAT THERE WAS NO NEED FOR AN SBA WHATSOEVER. AFTER LISTENING TO THE DEBATE OF NUMBERS, IT HAS BECOME STRIKINGLY CLEAR THAT NO EFFORT WOULD BE FORTHCOMING FROM THE ADMINISTRATION TO PROVIDE A CLEAR VOICE FOR AMERICA'S SMALL BUSINESSES - BE THEY 4 OR 14 MILLION IN NUMBER.

THE FUNDAMENTAL QUESTION IS TO WHAT EXTENT SHOULD THE FEDERAL GOVERNMENT PROVIDE ASSISTANCE - NOT TO SMALL BUSINESS; BUT TO ANYONE. IS THERE A PLACE FOR FEDERAL ASSISTANCE TO START OR FINANCE YOUR OWN BUSINESS? IT SEEMS TO BE A MORE PRUDENT POLICY TO HELP SOMEONE THAT WILL RE-PAY THEIR LOAN AND ADD TO OUR TAX REVENUES THAN TO PAY A FARMER NOT TO PLANT CROPS FROM YEAR TO YEAR.

CONSISTENCY IS THE PROBLEM WE ARE SEEING IN PUBLIC POLICY. SBA IS TO BE ELIMINATED FOR ITS INTERVENTION IN THE FINANCIAL MARKET PLACE. HOW THEN, CAN THE GOVERNMENT JUSTIFY AN ANNUAL $2 BILLION TO UNDERWRITE LOWER INTEREST RATES FOR LARGE BUSINESSES THROUGH INDUSTRIAL DEVELOPMENT BONDS (IDB'S)? IF SBA IS SUPPOSEDLY SUBSIDIZING INTEREST RATES, HOW CAN THE ADMINISTRATION HAVE HELPED TO CREATE A REAL ESTATE INDUSTRY THAT IS VIRTUALLY TAX EXEMPT DUE TO ITS COMPLEX TAX BENEFITS?

IF THE SBA IS NOT CREATING CAPITAL, BUT SIMPLY "MISALLOCATES IT TO THE LEAST EFFICIENT USERS" WHY THEN DO WE ALLOW OVER $120 BILLION DOLLARS IN CORPORATE MERGERS, THAT ABSORB CAPITAL AND CONCENTRATE POWER WITHOUT ANY ECONOMIC GROWTH OR NEW EMPLOYMENT?

IF THE TRUE ARGUMENT TODAY WERE THE BUDGET DEFICIT, SBA WOULD BE LOW ON THE PRIORITY LIST. SMALL BUSINESS OWNERS THEMSELVES CAN UNDERSTAND A CUT IN SBA FUNDS TO HELP PAY THEIR FAIR SHARE.

IN THAT LIGHT, MR. CHAIRMAN, YOUR BILL, S. 408, IS A COMMENDABLE STEP TO RETAIN AN INDEPENDENT SMALL BUSINESS AGENCY, WHILE PROVIDING A 30% CUT THAT SHOWS A RESPONSIBLE SPENDING POSITION. IF OTHER AGENCIES AND COMMITTEES WOULD BE SO BOLD AS TO PROPOSE FREEZES IN AGENCIES AND CUTS IN PROGRAMS, WE WOULD BE MUCH CLOSER TO THAT $50 BILLION DOWN PAYMENT.

TO SAY THAT SBA'S BUDGET SHOULD BE ELIMINATED, WHEN ITS TOTAL ANNUAL BUDGET WOULD ONLY RUN THE DEFENSE DEPARTMENT FOR 5 HOURS IS ABSURD. THE $661 MILLION IN AUTHORIZED SAVINGS YOU HAVE FOUND ARE A SOLID STEP TOWARD FISCAL ACCOUNTABILITY THAT SHOULD BE FOLLOWED BY OTHERS.

Senator **Bumpers**. Mr. Doyle, let me say that that was an excellent statement and that you and I agree on one thing: Everybody is for balancing the budget and cutting the deficit.

I have supported Senator Hollings' budget freeze in both 1983 and 1984, and I got some criticism from the Chamber of Commerce for that, even though it was a much more draconian cut than the President's. I have voted against the President's budget cuts sometimes because I didn't think he went nearly far enough.

But I agree with you on this point: It is unfortunate that you have to placate 535 people in order to get anything done around here, or a majority of 535 people have to agree at some given moment on a list of priorities. Right now, I think that the people of this country—and the Budget Committee reflected this the other day—feel that the defense budget is absorbing so much of our national resources that we are destroying our national character.

When the President vetoed the farm bill yesterday, the total budgetary impact was $100 million, not $3 billion. That is one-third of one MX missile. So, as I say, my disagreement with the President is on the priorities. It has nothing to do with strong defense. I have never known anybody in my life that favored a weak America. Have you?

Mr. **Doyle**. No.

Senator **Bumpers**. Did you ever meet anybody that said, "I believe in unilaterally disarming," or, "I favor a weak America," or, "I don't love the flag and my country"? I have never met anybody that I thought loved their country more than I did. We all love the country, and we are all trying—it is like getting to heaven, you know. We take different courses, but that is where we are all trying to get to.

So it is with my disagreements with the President. If you keep 500,000 to 1 million youngsters from getting an education in order to finance defense spending that is admittedly out of control, you know, you are going to pay a very, very high price down the pike. You are going to see the functionally illiterate numbers start going up in this country. And here we are trying to compete in international competition. Everybody will tell you that the technological edge is going to those who do the best job of educating their youngsters.

So all of your points are extremely well taken, and I agree with virtually everything all of you have testified to. I think that there just simply is not an understanding of the economic benefits from these programs.

I am a former small businessman. Before I got into politics and did a lot of other things, I had a small hardware, furniture, and appliance store, five employees, and that is about where most of the companies in this country are right now.

I never got an SBA loan and never sought one. But I got to the point where I almost had to steal to stay in business. I mean, I owed more people than I didn't owe, and just kept hanging on because—well, I wasn't brought up to believe that bankruptcy was immoral; I was just brought up to believe that you didn't do it; you worked your way out. But there were times when I sure owed a lot more than I had, and I just kept toughing it out and maintaining five jobs for five people who needed those jobs desperately, not the least of which was me. [Laughter.]

So I just see this thing in terms of human effort, human misery, and I see it not in ideological terms but in terms of jobs.

Every poll I have seen for the past 3 years shows that when you ask people, the No. 1—I am not talking about extemporaneously asking them what they feel about something, because if you go to one section of the country, it may be farms; someplace else it may be busing or something else—but if you give people a list of 10 things that they think are the most vital to this country, it is economic expansion and jobs. If you don't have a job, I can tell you one thing: That is by far the most important thing for you.

Mr. **Doyle**. That is right.

Senator **Bumpers**. So, I disagree with David Stockman just philosophically on this thing, because all I am trying to do is create jobs in this country for people, make the economic pie bigger, and give everybody a little bit bigger slice of it. That is what we all are looking for, and that is what the people are looking for.

I have not heard one single person, except David Stockman, say that he thinks SBA is bad philosophically and that it is not working well. We have heard nothing but the highest praise. Now, maybe our witness list has been loaded.

But, as I said earlier in the first day's testimony, Senator Weicker and I did not just arbitrarily throw this in to antagonize David Stockman or the President. It was a very meticulously thought-out bill. It cut $661 million in spending over the next 3 years.

That brings me to you, Mr. Donley. You suggested that we totally abolish the Direct Loan Program. As you know, we have abolished it for everybody except the handicapped, veterans, and MESBIC's. And, incidentally, we have had some amazing success stories testified to here in those three programs.

But I am not totally averse to the proposition you submitted, that perhaps we should abolish those and raise the Guaranteed Loan Program for those categories. What would you raise it to?

Mr. **Donley**. I would think 90 percent to at least——

Senator **Bumpers**. Well, now, our regular Guaranteed Loan Program is 90 percent, for the most part.

Mr. **Donley**. The agency is expanding the Preferred Lenders' Program from roughly—oh, very few banks right now, about 10 banks in 3 of the 10 districts that the agency covers, during this year they are planning to expand up from what is about 30 banks to probably over 600 banks in each of the 10 regions. They will have a maximum guarantee of 75 percent.

So with that increase of banks participating in the program, and with the decrease in the guarantee, I think, there would be room. We admit that it is, I think, a new proposal, and I think it is a bold proposal. I don't have enough experience or research talent at the chamber to know if it will work, but I think that that differential between 90 percent and 75 percent should get banks into that business.

I think the same criteria would apply to the people getting the loans, and so we assume that—and there are a number of success stories. Some of them have been SBA award recipient winners over the last year. They can make it if they get that initial help of financing.

Senator **Bumpers**. You also suggested reducing the definition of small business to 100 employees or less, did you not?

Mr. **Donley**. No; I did not suggest that.

Senator **Bumpers**. Was that you, Mr. Doyle?

Mr. **Doyle**. It was.

Senator **Bumpers**. Mr. Doyle, let me ask you something. Have you done any research on that proposition?

Mr. **Doyle**. Very much so, because they have been trying to change, and they eventually did change, the size standards. It has gone up for years.

Senator **Bumpers**. What percentage of SBA's Guaranteed Loan Program goes to businesses with more than 100 employees? Do you know that?

Mr. **Doyle**. I don't know that number, offhand. I do know that in the 503 Program, you get a much higher number of people that are what I would call midsize businesses getting loans, and we feel that it is much easier to process a larger loan, even through 503, than through the 7(a), and that is probably where you get a larger number, that and the procurement area.

I think the emphasis in procurement has gone to the larger firms which can go through the morass of paperwork and getting a Federal contract, and it has gone to the larger one rather than the small one. That is one of the reasons we were supporting that.

Senator **Bumpers**. Do any of the rest of you have any thoughts on that?

Mr. **Shattuck**. Yes, sir.

Senator **Bumpers**. Mr. Shattuck.

Mr. **Shattuck**. A couple of comments, sir. I think the whole idea of helping just those firms with 100 employees or less leaves out an awful lot of firms that need help in the financial assistance area, SBIC area, the 503 Programs, and others. I think you would be leaving out an awful lot of very deserving firms, sir.

I would like to add a couple of points. You talk about where the detractors are besides Mr. Stockman. I would like to refer you to the report put out by the Heritage Foundation which I thought probably might have triggered the Stockman reaction on eliminating the agency.

I think for a foundation with the standing of the Heritage Foundation to put out a report like that is a disgrace. It is totally inaccurate. It has been disproven in most of the findings. I think that it is unfortunate that it got as much play as it did in the press, sir.

And a third point: You indicated that when you had your hardware store with five employees, you never needed to go to the SBA, and I think that is——

Senator **Bumpers**. I didn't say that. I just didn't know about it. If I had known about it, I might have gone to them, because I would have gone to anybody; I was so desperate. [Laughter.]

Mr. **Shattuck**. I think there are an awful lot of people in the business world who may not use the SBA but know it is there, and it is comforting. It is like the local fire department. You may not have a fire today, but you might have one tomorrow. I think to eliminate the agency on the basis of the fact that few companies use it does not give it any credence at all as to why it should not be there, sir.

For those organizations that have businesses who advocate, because they have not been to the agency, therefore it should not be there, is to overlook all the good that it has done.

As a matter of fact, in hearing some of the testimony for the last few hours here, I could make a very strong case, sir, for the agency increasing in size and in appropriation on the basis of the payback to the Government in terms of jobs and tax revenue. I think maybe we need a bigger SBA. It only has 4,000 employees.

I think that maybe the—in the recommendations to look at the agency at the White House Conference between now and September 1, it might be a good idea to come back with a very strong program, and that program might just be on the basis of our collective organizations to make an agency much bigger than it is and to expand its programs. We will be glad to come back at that time and give you our findings.

Mr. GALANTY. Senator, can I make a comment on your size standards?

Senator BUMPERS. Sure.

Mr. GALANTY. I am currently chairman of the SBLC, but also, in my paid capacity, serve as the executive director of the National Association of Brick Distributors, which is generally a very labor-intensive industry. Many of the brick manufacturers have multi-hundreds of employees and do not generate multimillions of dollars in order to support that.

So we would be more in favor of a combination of employee-sales standards rather than a strict employee size standard, because we think that is a more fair representation of what is a small business.

A company may have 200 employees but may only generate a few million dollars' worth of sales, and you break that down per person, then it comes up a little more equitable, we think.

Senator BUMPERS. Well, there is one other point I would like to make, Mr. Doyle, and that is, when it comes to subsidizing big business through IDB's, it is only fair to state that the administration wants to do away with those, too.

Mr. DOYLE. You are right. If the small issue area of IDB's worked at all, it might be something which would be a very good adjunct to SBA, but in our experience, even that has not worked very well.

Senator BUMPERS. You know, I don't think that would be a bad proposition at all for small businesses. The only thing is, you are asking the community—in my State, you are asking the community to approve IDB's on somebody's financial statement.

Mr. DOYLE. Right.

Senator BUMPERS. And when you take small businesses, some of which do not have that kind of financial statement, to justify an IDB, I am not sure that it would work that well.

Mr. DOYLE. Yes. The legal costs are also very high.

Senator BUMPERS. Yes.

Gentlemen, I thank all of you for coming this morning. Your testimony has been excellent.

Our last witness this morning is Susan Garber, president of the Association of Small Business Development Centers and director of the Pennsylvania Small Business Development Center.

Ms. Garber, welcome to the committee, and we look forward to hearing from you.

STATEMENT OF SUSAN GARBER, PRESIDENT, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS, AND DIRECTOR, PENNSYLVANIA SMALL BUSINESS DEVELOPMENT CENTER

Ms. **Garber**. Thank you, Senator.

My name is Susan Garber. I am currently the director of the Pennsylvania Small Business Development Center Program, and I am also president of the Association of Small Business Development Centers. My offices are located at the University of Pennsylvania and the Wharton School.

I would like to say that I appreciate this opportunity to testify before you on the Small Business Development Center Program. I will give you a little background on the program. Today there are 37 small business development centers which are located in 36 States. The SBDC's are primarily a counseling and training network for small businesses working in conjunction with SBA field offices, the SBI Program, SCORE and ACE Programs.

The reach of the program has been widespread. In fiscal year 1984, when 10 of the SBDC's were brandnew, in excess of 50,000 small businesses received SBDC counseling, and another 102,000 received training. Since the program's inception in 1979, 154,000 small businesses have received SBDC counseling, and 365,000 have received training.

Studies have shown that small businesses are particularly vulnerable in the first 5 years of life and that, although much failure comes from lack of capital, a good number of the failures come from lack of management expertise.

The SBDC Programs have been funded by the Small Business Administration to provide free management assistance and low-cost educational seminars for the small business owner in an effort to mitigate some of the problems that threaten their survival.

In addition to counseling and training activities, the SBDC's also maintain a research component. They have at least, in most cases, three categories of research. There is client-based research done individually for SBDC clients, community-based research which includes economic development, and neighborhood revitalization studies and a general data base development.

Before Congress passed the enabling legislation for this program, Public Law 96-302, it deliberated at great length about what would be the appropriate entities to deliver SBDC services. At that time, the decision was made that university-based SBDC's should play a major part in the national program.

I believe this decision was in recognition of the vast resources that were available through the universities, including schools of law, business, engineering, the major libraries, access to sophisticated computer systems, and the state-of-the-art research capabilities.

Since then, the SBDC Program has made even greater use of the university system but has also gotten much more involved in the private sector and other economic and business development offices to deliver the SBDC assistance.

For example, in Pennsylvania there are outreach centers in 20 local chambers of commerce, and in Connecticut, all SBDC counseling is delivered through seven regional chambers. In Illinois, the SBDC Program is coordinated through the State Department of Commerce and Community Affairs. In Florida, SBDC counsel is providing through 33 local chambers of commerce.

In conjunction with the universities, the SBDC's have developed a strong emphasis on technology transfer. More schools of engineering and law, departments of computer science, and other specialized areas of expertise have been integrated into the SBDC system.

One example is the new small business development center in Kansas, which will provide high technology assistance to small businesses through four engineering centers.

The small business development centers have also become linked with the agency's 503 Loan Program. Working nationally with the certified development companies that are an essential part of the 503 Program, the SBDC's are providing the technical and management assistance expertise that will make this already successful program a solid accomplishment in the partnership between Government and the private sector.

Many small business development centers have become full participants in SBA's new SBIR Program. The SBDC at St. Louis University is an example and has become heavily involved in training and management assistance in this important program for small business innovation and research.

These are just a few examples of the programs and the agencies with which SBDC's have integrated their resources. I have tried to give you a brief overview of the SBDC's activities.

Now let us look for a minute at the impact of the program. In 1983, the University of Georgia conducted a study of the impact of counseling on client businesses at nine mature SBDC's. The findings of this research demonstrate the tremendous impact that SBDC has had during its short lifespan.

One year after counseling, the SBDC's queried performed better than the general business population in terms of sales, profits, and employment. Sales increased 25 percent, profits by 83 percent, and employment by 23 percent above the rate of all businesses in the States surveyed.

More importantly, the study found that State and Federal direct taxes generated by this increase in performance far exceeded the investment that had been put into the program. For every single dollar invested of Federal funds spent on the program, $9.40 was returned to the Federal Government. For every $1 in State money supporting the SBDC Program, $10.90 was returned in new State taxes.

Two other pertinent examples of the SBDC's benefits to the community can be shown in Maine and Pennsylvania. The Maine SBDC, one of the first, created in 1977, demonstrated that client sales increased by an estimated $17 million. Increased employment was an average of 51 percent.

SBDC clients contributed an estimated $34 million of increased income into the State and paid an estimated $3.6 million in State and Federal taxes. The Maine program cost $1 for every $38 of increased client sales and returned $8 to the taxpayer for every $1 invested in the SBDC.

In Pennsylvania, according to a survey done on clients from October 1979 to December 1982, over 8,000 new jobs were created. The use of a Chase Econometric model estimated an annual 5,700 spin-off jobs. These jobs translated into over $44 million in increased tax revenue, enabling a return of $26.50 to the taxpayer for every dollar in Federal funds spent on the SBDC.

Additionally, 46 percent of the survey respondents experienced a profit increase after counseling, and 44 percent saw an increase in sales. Eighty-two percent of the respondents stated that they would recommend SBDC services to other businesses. This kind of result has been repeated State by State over the last 5 to 7 years.

Although the SBDC Program is still young, the statistics demonstrate that nationally the SBDC's have had significant, positive value to both small businesses and the communities in which they reside.

Recently, critics of the SBDC Program have referred to a survey which concludes that small business owners least prefer going to "college and university business administration teachers" for advice in business management. Perhaps there is truth to the statement if it is read by itself, but it is irrelevant when looked at within the context of the SBDC Program.

The fact that 150,000 small businesses sought out help from the SBDC's in 1984 belies the argument that they are unwilling to come to the universities. In fact, they are coming in substantially increasing numbers, not necessarily to the universities but to the small business development centers, which in some cases are located at universities but might also be located in a downtown storefront, in a chamber of commerce, or even in the office of a local bank.

The next question, then, is that once when a person finally requests assistance from an SBDC which is located at a university or elsewhere, who is providing the consulting and training?

The SBDC State directors and the consulting staffs are comprised of people with substantial years of private sector experience and strong educational backgrounds in management, finance, accounting, and other business disciplines. In addition, the SBDC system uses many private sector resources to deliver both counseling and training to small businesses.

The following table indicates the qualifications of SBDC State directors—the table is included in the prepared statement—their years of private sector experience, and the use of private sector resources to deliver SBDC counseling and training. I hope you will take the time to review the information in the table, as it is impressive.

To further illustrate, I will take one example, the first on the sheet, which is the Alabama SBDC. The SBDC director in Alabama holds a graduate degree and has had 5 years of nonacademic management experience in the private sector.

The SBDC utilizes private consultants 10 percent of the time to deliver consulting. Those consultants are paid for only 30 percent of their work; thus, 70 percent of the consultants' time is volunteered. Similarly, 50 percent of Alabama SBDC's training is done by private consultants, and all of those services are donated, given free of charge.

The statistics in the table, while very revealing, do not tell the entire story. Some significant factors need elaboration, including, for example, the actual work experience of some of the SBDC directors.

To be specific, the Maine director was formerly employed as an investment banker on Wall Street. The director of the Arkansas SBDC is a CPA with more than 5 years' private sector experience. The West Virginia director is a former Governor, and the South Carolina director has 20 years of banking experience.

Additionally, the SBDC background and work experience of subcenter directors is generally reflective of the education and work experience of the State directors.

The table therefore presents a telling view of SBDC's. Their staffs are generally very well educated and have anywhere from 2 to 35 years of private sector work experience. SBDC clients are getting service from a high-quality resource at a cost they can afford.

Additionally, SBDC's rely to a great extent on the private sector. As the table shows, as much as 70 percent of an SBDC's counseling, and 90 percent of an SBDC's training, may be delivered through the private sector. This negates the oft-stated criticism that SBDC's compete with the private sector.

In fact, only through the leveraging of resources provided by the SBDC's can a private consultant afford to work the small business clients in that segment of the market addressed by the SBDC. These businesses are small, with very limited resources. As they grow and expand their financial bases, these companies will seek out further assistance from private sector consultants on a fee-for-service basis.

In summary, SBDC's have proven to be an effective public-private partnership serving to both coordinate and deliver management assistance to small businesses.

By using the Federal funding as a base, the SBDC's have become catalysts in their respective States for developing and improving small business management assistance activities. The SBDC's have leveraged the Federal money with State, university, and private sector resources to reach a sector of the small business community that would not otherwise receive any assistance.

The Association of Small Business Development Centers and our members are constantly working to improve our individual programs and the national program. We look forward to continuing to work with this committee in achieving those goals.

Thank you.

[The prepared statement of Ms. Garber follows:]

Statement of

SUSAN GARBER
PRESIDENT
ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

AND

DIRECTOR
PENNSYLVANIA SMALL BUSINESS DEVELOPMENT CENTER

Before

THE SENATE COMMITTEE ON SMALL BUSINESS

March 7, 1985

Washington, DC

Mr. Chairman, my name is Susan Garber. I am the Director of the Pennsylvania Small Business Development Center and also President of the Association of Small Business Development Centers (ASBDC). I appreciate this opportunity to testify before you on the Small Business Development Center Program.

Today 37 Small Business Development Centers (SBDCs) located in 36 states provide a counseling and training network for small business in conjunction with SBA field offices, and the SBI, SCORE and ACE programs. The impact of the program is widespread. In fiscal year 1984, when ten new SBDCs came on stream, in excess of 50,000 small businesses received SBDC counseling and 102,000 received training. Since the program's inception in 1979, 154,000 small businesses have received SBDC counseling and 365,000 have received SBDC training.

Numerous studies have shown that small businesses are particularly vulnerable in the first five years of life and that failure comes most often from a lack of capital and an absence of sound management and planning practices. The SBDC program provides free management assistance and low-cost educational seminars for the small business owner in an effort to mitigate some of the circumstances that threaten small business' survival.

In order to provide a useful service to the business community, an SBDC must constantly update its information and perform primary research. Most research, undertaken in an effort to improve service quality or to answer specific client needs, falls within three basic categories:

Client-based research -- market and demographic surveys, impact studies, resource guides and information handbooks.

Community based research -- economic development and neighborhood revitalization feasibility studies.

General data-base development -- bibliographies of available publications and resources, economic trends and projections, and analyses of business activity in service areas.

Research results are exchanged between SBDCs and with other interested agencies, thus helping to reduce wasteful duplication and to generate new applications of original research.

Before Congress passed the enabling legislation (P.L. 96-302) authorizing the SBDC program, it deliberated at great length about what were the appropriate entities to deliver SBDC management assistance. In doing so, it decided that university-based SBDCs should play a major part in the new national program. I believe this decision was in recognition of the unique and vast resources -- schools of law, business and engineering; libraries; access to sophisticated computer systems; and, state of the art research capabilities -- available through universities.

Since then, with the support of the ASBDC, SBA has been exploring various means of greater utilization of the university system, the private sector, and other economic and business development offices to deliver SBDC assistance. For example, in Pennsylvania, SBDC outreach centers have been established in 20 local chambers of commerce; in Connecticut all SBDC counseling is delivered through 7 regional chambers of commerce; in Illinois, the SBDC program is coordinated through the State Department of Commerce and Community Affairs; and in Florida, SBDC counsel is provided through 33 local chambers of commerce.

At the university level SBDCs are developing a strong emphasis on technology transfer. More schools of engineering and law, departments of computer science, and other specialized areas of expertise are being integrated into the SBDC system. As an example, the new small business development center in Kansas will provide high technology assistance to small businesses through four engineering centers. These centers, established by the Kansas State Legislature, are located at Kansas State University, Pittsburgh State University, University of Kansas and Wichita State University. These institutions will place special emphasis on technical assistance to small business. Another Kansas center has long provided excellent assistance to industrial businesses.

The small business development centers are also assisting in community economic development. Linkages are being established, for example, with the agency's 503 loan program, a successful community economic development program that has received wide usage throughout the country. Working with the certified development companies that are an essential part of the successful operation of this program, small business development centers are providing the technical and management assistance expertise that will make this already successful program a solid accomplishment in the partnership between government and the private sector.

Many small business development centers are moving ahead as full participants in SBA's new Small Business Innovation Research Program. The SBDC located at St. Louis University, through its consortium schools of the University of Missouri, is heavily involved in training and management assistance in this important program for small business innovation and research.

The impact of the SBDC program has been tremendous. In 1983, the University of Georgia conducted a study of the impact of SBDC counseling on client businesses of nine mature SBDCs. The findings of this research are truly amazing.

One year after counseling, SBDC clients performed better than the general business population in terms of sales, profits and employment. Sales increased 25 percent, profits by 83 percent and employment by 23 percent above the rate of all businesses in those states.

Most importantly, the study found that state and federal direct taxes generated by this increase in performance far exceeded the investment in the program. For every one dollar in federal funds spent on the SBDC program, $9.40 was returned to the federal government in new taxes. For every one dollar in state money supporting the SBDC programs, $10.90 was returned in new state taxes.

A micro view of an SBDC's benefits to the community may be helpful. Two pertinent examples are Maine and Pennsylvania. The Maine SBDC was created in 1977. Since then, its client firms:

* increasesd sales by an estimated $17,100,000,

* increased employment by an average of 51%,

* contributed an estimated $34,200,000 of increased income in the state, and

* paid an estimated additional $3,600,000 in state and federal taxes.

The Maine SBDC program:

* costs $1 for every $38 of increased client sales and

* returned $8 to the taxpayer for every $1 spent by the SBDC.

In Pennsylvania, according to a survey of SBDC clients, from October 1979 to December 1982, SBDC assisted clients created over 8,000 new jobs. The use of a Chase econometric model estimates an additional 5,700 spin off jobs were created. These jobs translate into over $44 million in increased tax revenues enabling a return of $26.50 to the taxpayer for every $1 in federal funds spent on the SBDC. Additionally, 46 percent of the survey respondents experienced a profit increase after counseling by a center, and 44 percent saw an increase in sales. Further, 82 percent of the respondents stated that they would recommend the SBDC's services to other businesses.

In Wisconsin, the support for the program is even greater as 98 percent of the Wisconsin SBDC clients support the program, plan to use SBDC services again and would recommend SBDC services to others.

Although the SBDC program is still young, these statistics demonstrate that nationally the SBDCs have had significant, positive value to both small businesses and the communities in which they reside. Recently, critics of the SBDC program have referred to a survey which concludes that small business owners will not go to "college and university business administration teachers" for advice in business management. This is probably a true statement but irrelevant to any review of the SBDC program. The fact that 150,000 small businesses sought help from SBDCs in fiscal year 1984 belies the argument that they are unwilling to come to the universities.

They are coming in increasing numbers -- not to the universities, but to the small business development centers which in some cases are located at universities, but might also be located in a downtown storefront, in a chamber of commerce, or even the office of a local bank.

Once a small business person requests assistance from an SBDC, who is providing the consulting and training services? The SBDC state directors and the SBDC consulting staffs are comprised of people with substantial years of private sector experience and strong educational backgrounds in management, finance, accounting, and other business disciplines. In addition, the SBDC uses many private sector resources to deliver both counseling and training to small businesses. The following table indicates the qualifications of SBDC state directors, their years of private sector experience, and the use of private sector resources to deliver SBDC counseling and training.

To illustrate further, Mr. Chairman, let me explain the table by referring to the Alabama SBDC. The SBDC Director in Alabama holds a graduate degree and has five years non-academic management experience in the private sector. The SBDC utilizes private consultants 10 percent of the time to deliver counseling. Those consultants are paid for only 30 percent of their work; conversely, 70 percent of the consultants' time is volunteered. Similarly, 50 pecent of

BDC	Directors Education Graduate Degree Yes	No	Directors Years of Private Non-Academic sector Experience	Percent of SBDC Counseling Delivered thru private source (cost reimbursement basis)	Percent of SBDC Training Delivered thru private sour (cost reimbursement basi
lahoma	X		5 (management)	10% (30%)	50% (0)
rkansas	X		3 (CPA)	0	50% (10%)
onnecticut		X	35 (management)	10% (5%)	90% (10%)
lorida	X		2 (manufacturing)	15% (1%)	65% (5%)
eorgia			4 (management)	30% (10%)	65% (50%)
llinois		X	9 (management)	42% (20%)	40% (15%)
wa	X		2 (management)	53%	53% (60%)
nsas	X		7 (management)	50% (95%)	70% (85%)
ntucky	X		21 (management)	10% (10%)	80% (10%)
uisiana	X		28 (management)	25% (2%)	15% (0)
ine	X		15 (management)	10% (100%)	25% (100%)
ssachusetts	X		9 (management)	10% (9%)	64% (58%)
ssissippi	X		12 (management/industrial development)	10% (100%)	25% (80%)
ssouri	X		20 (management/business owner)	20% (5%)	65% (15%)
braska	X		3 (technical/journalist)	30% (90%)	25% (80%)
w Jersey	X		4 (technical)	20% (20%)	10% (80%)
w Hampshire	X		3 (management)	10% (5%)	50% (50%)
w York	X		5 (management)	10% (2%)	20% (8%)
egon	X		5 (management)	40% (10%)	90% (50%)
nnsylvania	X		5 (management)	5% (0)	76% (0)
ode Island		X	7 (technical)	70% (90%)	40% (50%)
uth Carolina		X	20 (management)	7% (65%)	48% (97%)
nnessee	X		16 (management)	13% (10%)	90% (2%)
xas (Houston)	X		15 (management)	30% (10%)	60% (50%)
ah	X		18 (management)	15% (13%)	30% (25%)
st Virginia	X		20 (management)	10% (0)	40% (0)
sconsin	X		12 (management)	30% (25%)	50% (48%)

the Alabama SBDC's training is done by private consultants and all of those services are donated.

The statistics in the table, while very revealing, do not tell the entire story. Some significant factors need elaboration including, for example, the actual work experience of SBDC Directors. To be more specific, the Maine SBDC Director was formerly employed as an investment banker on Wall Street; the West Virginia Director is a former Governor; the South Carolina Director has 20 years of banking experience; and the Oregon Director was formerly with Xerox Corporation. Additionally, the educational background and work experience of sub-center directors is generally reflective of the education and work experience of the State Director.

The table therefore presents a telling view of SBDCs. Their staffs are generally very well educated and have anywhere from two to thirty-five years of private sector work experience. SBDC clients are getting service from a high quality resource at a cost they can afford.

Additionally, SBDCs rely to a great extent on the private sector. As the table shows, as much as 70 percent of an SBDC's counseling and 90 percent of an SBDC's training may be delivered through the private sector. This negates the oft-stated criticism that SBDCs compete with the private sector. In fact, only through the leveraging of resources provided by the SBDCs can a private consultant afford to work with small business clients in that segment of the market addressed by SBDCs. These businesses are small with very limited resources. As they grow and expand their financial bases, these companies will seek out further assistance from private sector consultants in on a fee-for-service basis.

In summary, SBDCs are an effective public, private partnership serving to both coordinate and deliver management assistance to small business.

By using the federal funding as a base, the SBDCs have become catalysts in their respective states for developing and improving small business management assistance activities. The SBDCs have leveraged the federal money with state, university, and private sector resources to reach a sector of the small business community that would not otherwise receive any assistance. The ASBDC and our members are constantly working to improve our individual programs and the national program. We look forward to working with this Committee in achieving those goals.

Senator Bumpers. Thank you, Ms. Garber.

Ms. Garber, the only comment I would make is that I have been fairly close to this program because of the one we have in Arkansas. It is run by a very good friend of mine. I have talked to him, and as a matter of fact, I spoke at one of their seminars the other day. And in visiting with him and the other people affiliated with it, they have convinced me that it is working extremely well.

Then, just the other day, unsolicited, a friend of mine who owns a small retail outlet in southeast Arkansas called to tell me that he was enrolled in the program and it had really been a tremendous help to him.

Ms. **Garber.** Well, I am glad to hear that.

Senator **Bumpers.** So that is pretty much my experience with it. The consensus of the conventional wisdom around here is that these things are just ripoffs that go to the States of the respective members of this committee. I must say, I am not averse to having one in my State, but by the same token, that was not the genesis of it, nor is it the thrust of it now.

Senator Kasten.

Senator **Kasten.** I think the reason that I might have one in my State had nothing to do with me but possibly had a little bit to do with my predecessor.

Senator **Bumpers.** Yes. [Laughter.]

But you are not going to kick them out just because Gaylord was on the committee, are you?

Ms. **Garber.** Both of your States have excellent directors.

Senator **Kasten.** I have no questions for this witness. I appreciate your testimony.

Senator Bumpers. Ms. Garber, thank you very much for your testimony and coming over to be with us this morning. It was an excellent statement.

Ms. **Garber.** Thank you, Senator Bumpers.

Senator **Bumpers.** This concludes the hearings on S. 408. The hearing record will remain open for 2 weeks to receive additional testimony and statements for the record. The committee will stand adjourned.

[Whereupon, at 12:02 p.m., the committee recessed, to reconvene at the call of the Chair.]

APPENDIX

TASA

THE AMERICAN SURETY ASSOCIATION

1001 N. Highland Street, Suite 101, Arlington, Virginia 22201 • 703/528-0072

STATEMENT BY
DR. JOHN F. MAGNOTTI JR.
EXECUTIVE VICE PRESIDENT
THE AMERICAN SURETY ASSOCIATION

FOR THE
SENATE COMMITTEE ON SMALL BUSINESS
FEBRUARY 21, 1985

The American Surety Association is pleased to submit the following statement to the Senate Committee on Small Business in support of S.408, the Small Business Authorization Bill for Fiscal Years 1986-1988.

The American Surety Association is an association which unites surety companies, their agents, and that part of the legal community which supports surety firms and agents. The association is concerned particularly with the proposal of the Office of Management and Budget to eliminate the Small Business Administration and those programs included under the collective heading of "loan guarantee programs."

We believe that the administration is making a grave error in eliminating the Small Business Administration and more particularly in proposing the elimination of the Surety Bond Guarantee program. As taxpayers we are sensitive to the burgeoning cost of government and the potential for increased taxes. However, we feel just as strongly that the Surety Bond Guarantee program is absolutely necessary to the survival of thousands of small contractors across the United States. Further, instead of being a burden to the taxpayer, the Surety Bond Guarantee program saves the government millions of dollars each year.

THE AMERICAN SURETY ASSOCIATION

The argument made for eliminating many of the Small Business Administration programs by the Office of Management and Budget is that the small businessmen involved would be better served by the private sector. In the case of the Surety Bond Guarantee program, it is run by the private sector and supervised by the Small Business Administration. Both the private sector and the government share the risk in order to provide small and minority contractors with bonds which are not available to them in the standard surety market. Bonding, of course, is required by the Miller Act for all contractors working on government contracts. Thus, elimination of the only bonding source available to contractors without an impressive track record will have the immediate effect of eliminating thousands of contracting firms, and jobs, from the construction market.

It can be conclusively proved that the program makes a positive financial contribution to the government. At the national level, the estimate of public savings from the program from its inception in 1971 through 1984 is estimated to be approximately $917,739,400. An analysis was made in 1977 of all bonded nonnegotiated contracts guaranteed by the Small Business Administration to project the difference between the contract award prices and the bids of the second lowest bidders on publicly financed contracts. The bid differential or "bid spread" represents cost savings to the government as a direct result of the operation of the Surety Bond Guarantee program.

The 1977 study showed that 38.7 percent of all Surety Bond Guarantee contracts are publicly financed and awarded through the formally advertised process. For these, the average bid spread was 9.25 percent, meaning that the second lowest bidder's price was on the average 9.25 percent higher than the winning low bid. In another study of 1,000 contracts completed in 1985, the bid spread had risen to 11.7 percent. The obvious conclusion is that when the Surety Bond Guarantee program is viewed as a part of a total government effort, the program has not only been self-sustaining but has provided substantial savings to governments at all levels.

In addition, there is an obvious benefit to both the government and the public at-large in supporting thousands of jobs in the contracts for which bond guarantees were provided. Construction firms provide jobs in many cases for individuals who are not highly skilled and for whom it is difficult to find employment.

In the Kansas City region, the Small Business Administration issued guarantees amounting to $80,000,000 for construction contracts for fiscal year 1984. The historical loss ratio was 1.18 percent or $944,000. To offset this loss, the region received $400,000 in processing fees from participating contractors and guarantee fees from sureties amounting to $200,000. The net loss for participation by the region in over 800 contracts was $344,000. This is not the final figure, however. The savings generated from an average bid spread of approximately 7.5 percent between the lowest and next bidder on $80,000,000 amounted to a savings to the government of $6,000,000 in construction funds. The net savings to the government, thus, is $5,656,000 in the Kansas City region alone.

We feel strongly that small business needs an advocate at the federal level. The Small Business Administration fulfills that role. Although there may be problems with the administration of some of the programs, on balance the administration of the Surety Bond Guarantee program has been excellent in Washington and throughout the country. The individuals working in the program understand the private sector and have worked in close conjunction with surety firms and agents to provide an efficient and effective bonding source for companies who under ordinary circumstances cannot find bonding in the standard surety market. In comparison to many government programs, the Surety Bond Guarantee program is being run effectively by very few government employees across the country.

In summary, we support your efforts to maintain the Small Business Administration and its role as an advocate for the thousands of small businesses in the United States. We urge that you consider our contention that the Surety Bond Guarantee program should stand on its own within the Small Business Administration as an effective and efficient program for providing small and minority contractors with the bonding necessary to work on government contracts and at the same time generating substantial savings to all levels of governments .

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February 22, 1985

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STATEMENT OF WOMEN BUSINESS OWNERS OF NEW YORK IN SUPPORT OF THE WEIKER/BUMPERS SMALL BUSINESS ADMINISTRATION AUTHORIZATION BILL

As the only professional organization in the New York Metropolitan area established exclusively by and for women entrepreneurs we wish to express our support for the Weiker/Bumpers Authorization Bill for the continued funding of the Small Business Administration for fiscal years 1986 through 1988 and our vigorous opposition to the Reagan Administration's proposal to disband the agency.

Our organization represents over 500 small business owners in the New York area and sponsors an annual Business Development Conference which was attended last year by women entrepreneurs throughout the United States. We know from first hand experience that women entrepreneurs are building substantial new businesses which provide opportunities for professional enhancement and leadership development for women at a time when increasing numbers of women are becoming the heads

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of households, with economic responsibility for themselves and their families.

As with all small businesses, these entrepreneurial enterprises create employment opportunities (for men and women), self sufficiency, and an innovative use of capital which contributes significantly to the overall growth and health of the american economy.

As important as the contribution of small business is to the health of the nation, we know from first hand experience that survival of such enterprise is difficult. We believe the support and assistance to small business which has been provided by the Small Business Administration makes a critical difference in the survival of such businesses. The Small Business Administration has an established record of providing assistance to small businesses. It is the one federal agency which small business knows it can turn to for the support, guidance and information which is critical to its continued economic health and expansion. This agency is the single advocate for the various

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interests of this important part of the economy, which differ significantly from the other section of the economy.

It seems ironic that this administration, which purports to vigorously support the traditional entrepreneurial spirit in American life, is seeking to dismantle the one agency whose function is to support and encourage that sector of the economy which most embodies these qualities - the small independently owned business. It is especially distressing to us since last Spring the New York Women in Business Conference, sponsored jointly by Women Business Owners of New York and the Small Business Administration was selected by President Reagan as a platform for expressing his support for small business.

We believe that the interests of small business will not be served by the Reagan Administration's proposal to split the agency into departments within the Departments of Commerce and the Treasury. On the contrary, we are convinced that such an action

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will result in no effective advocate for our interests. In addition, the disposing of the existing Small Business Administration loan portfolio as part of dismantling the Agency will, we believe, result in a loss to the government which will offset any gains which could be expected from administrative savings contemplated by the Administration's proposal.

All in all, we believe that the Administration's proposal to disband the Agency would work to the significant detriment of small business and the economy as a whole.

We believe the Small Business Administration must be preserved and that the Weiker/Bumpers proposal represents a fair response to the current need for restraint in governmental spending. We are happy to support the proposal and we urge the committee to bring the bill to the floor of the Senate promptly.

AMERICAN NATIONAL BANK
2992 Dixwell Avenue, Hamden, Connecticut 06518
Area Code 203 281-1000

LEONARD F. SUZIO, JR.
EXECUTIVE VICE PRESIDENT

December 27, 1984

Mr. Ronald Reagan
President of the United States
White House
1600 Pennsylvania Avenue
Washington, DC 20500

Dear Mr. President:

I am writing this letter to express my concerns about your intentions to dismantle the Small Business Administration Program. As a community banker who has specialized in financing small businesses during the last ten years, I believe the SBA has played a significant role in contributing to the financing of small business. Specifically, the SBA has benefitted the small business community by:

a. Making capital available that would not otherwise be accessible to encourage small business investment and expansion;

b. By effectively lowering the cost of capital to a level more affordable by small businesses; and

c. By extending the debt service burden and making capital available for a longer term.

The benefits of the SBA Program to the community are substantial. SBA financed businesses make a significant contribution to the local economy not only in the production of goods and services, but in the form of jobs and taxes as well. For example, American National Bank's portfolio of 100 SBA guaranteed loans totalling approximately $10 million is currently generating the following annual economic impact in our market:

a. Gross sales in excess of $50 million;

b. Number of employees 1500 - 1600;

c. Taxes paid over $1 million.

In 1983, the SBA purchased approximately $193,000 of guaranteed loans from American National Bank. Concommitantly, American National recovered approximately $178,000 in previously purchased guaranteed loans. Thus, the net loss to the SBA was only $15,000. This would seem to be a small price to pay for the economic results generated. In fact, I would suggest that in light of the economic benefits generated by the SBA Program, it may be the only government agency that generated a substantial "profit" for the government.

Even the GAO, which has been highly critical of the SBA acknowledges that it is the primary source of long term capital for the small business community in the United States. By encouraging the development and expansion of small business, the SBA Program promotes a more competitive economy and strengthens the free enterprise system. Not only are small businesses our primary source of jobs in the U.S., they are also a significant source of innovation. Furthermore, the highly competitive and independent spirit of the entrepeneur is a positive factor promoting a more competitive economy. To dismantle the SBA Program would be a significant blow to the American small business community.

Based on the foregoing, I respectfully suggest you reconsider your position on the SBA and focus on new ways to improve the SBA and make it an even more effective force to support the backbone of the American economy -- the small business community.

Sincerely,

Leonard F. Suzio, Jr.
Executive Vice President

LFS:lsm

bcc: Jack Burke
Bill Wallace
Al Mandel

BUDGET PROPOSALS
FOR
CONTINUATION OF SBA

Prepared by:

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Introduction: The Administration's budget proposal to abolish the Small Business Administration is without merit and extremely shortsighted. This paper first sets forth several reasons why the SBA is needed in the small business community. Secondly, several suggestions for budget cuts and program changes are made which would result in a savings of approximately $400,000,000 in budget outlays for the SBA.

The Administration's proposal to terminate the SBA reportedly finds its origin in a philosophical belief that government should not involve itself in a free capital marketplace. The facts are that the government is everywhere in every marketplace. In this writer's opinion, Mr. Stockman and his staff have forgotten to ask a very important question - "Does government involvement promote competition and is it cost effective?" Put another way - "Is the government's involvement productive and does the American taxpayer get sufficient return on his invested tax dollar?" As these questions relate to the SBA, the answers are, for the most part, a very positive "yes". Those of us involved in the financing of small business over the last dozen or so years have seen many SBA programs contribute in a profitable and positive manner to the small business community.

To support the survival of SBA one must subscribe to two beliefs. The first is that there is a lack of long-term capital available to credit-worthy small businesses. The second is that the SBA has fulfilled to some satisfactory degree those needs for long-term capital. The writer is currently the Chief Executive Officer of a Small Business Investment Company (SBIC), a specialized commercial financing company, and a small, full service, community bank. Every one of these entities is involved with the financing of small business. Various financing vehicles are used, including SBA guaranteed loans. From the writer's past and current experience, a strong statement can be made that there continues to be a need for long-term capital for small business that is not met by the banking industry and other lending institutions for any number of reasons. Some explanation of these reasons is necessary.

First, big banks like big loans. Small businesses are usually not in the market for multi-million dollar loans. The continued demise of the small independent bank in favor of large holding companies and the national banking chains such as Citicorp has made borrowing more difficult for many small businesses.

Many small businesses get their loans from small community banks, and often these banks have loan limits which are not large enough to meet all of the capital needs of a borrower.

Another reason, and one that is most frightening, is the recent "panic" in the Office of the Comptroller of the Currency which regulates national banks. As a result of that office's miserable performance relative to bank failures such as Penn Square, Continental Illinois, etc., this "panic", begun in the last two or three years, has begun to affect small banks and small businesses. Ask any small banker what his or her attitude is toward the recent conduct of the examining corps of the Office of the Comptroller of the Currency and you will hear any number of horror stories. Briefly, this failure on the part of the Comptroller's Office is basically due to an antiquated and ineffective examination system and the staffing of that office with inexperienced and ill-trained personnel. The writer could spend days on this subject, but wishes only to point out that developments within the Office of the Comptroller are having a significant negative effect on banking and the small business community. Suffice it to say that in many instances term loans to small businesses will almost certainly be classified as substandard or worse by bank examiners.

Additionally, there is the continuous regulatory pressure on banks to keep loans in short-term maturities to match the maturities of deposits. Bankers are reluctant to make commercial loans for maturities.in excess of 5 years.

These are but a few of the reasons why it is necessary that we maintain a marketplace, and lending programs such as SBA guaranteed loans, which continue to make long-term capital available to small business.

In this light, it is the writer's opinion that the primary positive contribution of the SBA have been the administration of those programs which have provided long-term capital to deserving, credit-worthy businesses. Certainly, other programs have, and are, making positive contributions to the small business community. Most of these programs should be maintained, if possible. However, faced with a popular demand for deep budget cuts in domestic programs, this report purposes a "bare bones" program for the survival of SBA. The report is not to be construed as the writer's opinion of the perfect SBA or how the agency should exist given adequate funds for various programs. As previously stated, most programs are doing their jobs well. The purpose of this report is to provide congress and the SBA with ideas as to how the SBA's budget might be reduced and allow for the continuance of the SBA and most of its programs. Again, what follows is a "bare bones" proposal for the continuance of the SBA and, in most cases, is not to be construed as a criticism of programs proposed for cuts.

SBA Business Loan Guaranty Program - Realistically, this program, with approximately 2.6 billion dollars in annual guarantee allotments, has the greatest impact of all of SBA's programs. Just as realistically, this program has been SBA's most costly in terms of cash dollar outlays. Losses on defaulted loans for 1984 were estimated to be $500,000,000. Net cash outlays after all income and expense were expected to be approximately $500,000,000 for 1984. Estimates for net cash outlays for 1985 were estimated at $296,000,000 primarily because of improved loan loss performance.

Some have suggested that the one point guaranty fee paid by the borrower on the guaranteed amount of a loan be raised to two or three points in order to make this program more cost effective. Such increases only serve to raise the borrower's cost - something the program is supposed to avoid. It is this writer's belief that the way to lower the cost of a loan guaranty program is to eliminate some aspects of that program, and change other aspects in order to improve loan quality and lender quality.

The most important reform that can be made in the guaranteed lending program is the change of the guaranty mix from 90% government and 10% lender, to 80% government and 20% lender. It is believed that an 80% guaranty will still provide sufficient inducement to get private lenders to continue to make long-term loans. It is also believed that the 100% increase in exposure resulting from the 80% - 20% mix will sufficiently increase a lender's exposure to risk to insure a more thoughtful credit decision and a resulting higher quality loan. If this change in guaranty mix is made, it is essential to allow approved lenders to co-participate or share in the unguaranteed portions of loans in order not to strain the capital of small lenders.

Again, it is essential that the SBA guaranteed lending program be viewed as a loan program designed to provide long-term capital to credit-worthy small business concerns. The SBA is currently conducting two lending programs which put an emphasis on loan quality. The Certified Lenders Program ("CLP") provides a three day turnaround from the SBA for loans originated by lenders who have a reputation for being active in SBA lending and originating quality loans. This program has been expanded as to lender responsibility and exposure in the Preferred Lenders Program ("PLP"). Under PLP an approved lender can make a credit decision in the lender's office without consulting with the SBA. However, one very important feature of this program is that the guaranty mix is 75% government and 25% lender. It is believed that both of these programs should be continued with emphasis given to lender qualification and to supervision of lenders by the SBA.

There have been many figures mentioned concerning losses in the guaranteed lending program. Currently, losses appear to be about 5% of average gross loan portfolio. This figure must be reduced to the 2% to 3% range over the next three years. The writer believes that changing the guaranty mix will accomplish this goal. If such a reduction cannot be accomplished over the next three years, consideration should be given to further amending the program to get loan losses in the desired range.

SBA Disaster Loan Programs - The SBA loan program for direct physical disasters should, of course, be retained. Few will argue that there is a moral obligation for the government to assist businesses devastated by natural disasters. Happily, the disaster loan program, as it relates to physical disasters, has had a good payback record. However, so-called nonphysical, or economic disaster loans, are a horror. A recent example of this ill-conceived program has been the Administration sponsored "pesos loans" to businesses bordering Mexico, as a result of the devaluation of the Mexican peso. One can find economic sense in lending money to a business devastated by a hurricane. It is quite another matter to financially support a business which has no market future for its products or services. The nonphysical loan program should be abolished.

Another type of disaster loan placed at the feet of the SBA is the Farm Disaster Loan Program. Again, this program makes no economic sense. The Farmers Home Administration is already wrestling with the financial problems of the farmer and the program laid on the SBA is in many ways nothing more than a duplication of the Farmers Home Administration Program.

Over the years those of us in the field who have watched various disaster lending programs have noted that there is very little abuse and dishonesty in the physical disaster program. However, in the Farm Disaster Program, when it was previously administered by the SBA and, especially in the so-called economic disaster program, we have seen numerous abuses. In short, because of ill-defined parameters as to what a "disaster" is, many businesses with absolutely no need of funds took advantage of low interest rates to improve their overall financial condition when they had actually not been "damaged".

In summary, the physical disaster program should be continued and all other forms of disaster lending terminated immediately. The writer is unable to establish what actual savings will accrue to SBA if these two terminations are done.

Direct SBA Business Loans - This program has been an economic disaster. Losses have reportedly been in excess of 25%. Additionally, borrowers seeking direct SBA loans have been turned down by at least two lending agencies. Often the turn downs have come from lenders who had considered the borrower for the guaranteed loan program and declined the credit.

Many SBA loan officers in the field have long wanted this program abolished. It takes an exhorbitant amount of time to administer. This writer feels that the SBA loan officer should be concentrating on supervising lending activities of private sector lenders in the guaranteed lending program rather than being bogged down in the day to day operational aspects of direct lending.

Eliminating the direct business loan program results in some interesting numbers. First, SBA outlays would be reduced by approximately $200,000,000. More importantly the losses on these loans which currently amount to some $300,000,000 per year will begin to diminish. While the reduction in losses will not have an immediate effect on SBA's budget, it can be anticipated that three years from now loan losses on the direct lending program could be reduced by as much as a $100,000,000 a year with subsequent annual losses continuing to decline. It is proposed that one direct loan program be continued. The Minority Enterprise Small Business Investment Company (MESBIC) debenture program should be continued. This program has had some success. While outlays are estimated to be $41,000,000, the SBA investment in this area is protected to some degree by the private capital of the MESBIC's which are funded through the debenture program. Additionally, MESBIC's will be included in the new "capital bank" which is being proposed to achieve the "privatization" of the MESBIC and SBIC industry.

Management Assistance - Many of us have watched SBA's efforts over the years to implement congressionally mandated management assistance programs for small business. There can be no doubt that these programs have been well intentioned. However, many observers, including many within SBA, feel that these programs have, for the most part, not worked. No one will argue that small businesses often lack management expertise. However, while it may be the role of government to provide educational services to the small business community, it certainly should not be the business of government to actually manage a small business for its owner. Practically speaking, once a loan has been made to a borrower who subsequently exhibits a lack of managerial ability, there is little, short of direct intervention, which can be done to help that borrower. It is this writer's belief that lenders and the SBA, especially those people in the field, have come to acknowledge this and as a result, a better job of investigating and analyzing the prospective borrower is now being done. In other words, the best way to avoid the burden of managerial assistance/intervention is to make loans to borrowers who do not require such assistance and/or intervention.

Many of us in the business of lending to small businesses believe that it should be the burden of the lender to provide managerial guidance to borrowers. It is felt that the various reforms which have been proposed for the private sector relative to the guaranteed lending program will provide sufficient incentive for the private lender to provide needed management assistance to a borrower. If a lender is at greater risk, that lender will be more inclined to become involved in turning a floundering business around through managerial assistance.

Some of the duties of the Management Assistance group can be taken over by Score and Ace volunteers. Certainly, the Score and Ace volunteer programs should be retained. Other programs can and should be taken over by state and local governments.

One of the newer programs under Management Assistance is the Small Business Development Center Program (SBDC). The program involves contracts with various colleges and universities which for 1984 were estimated to cost approximately $22,000,000. For the present time, it is recommended that this program be reduced, but not terminated.

In 1984 the Management Assistance group employed 325 people with a budget of $40,000,000. It is recommended that the number of employees in this division be reduced to 200. It is also recommended that the overall budget for Management Assistance be reduced to $21,000,000. Such a reduction would result in a savings of approximately $19,000,000.

Pollution Control Guaranty Program - This program was started in 1976 to help small businesses meet Enviromental Protection Agency clean air standards. The program reportedly has suffered severe losses and has been ineffective. Additionally, eight years have gone by since the program's conception, and established businesses have had sufficient time to avail themselves of the program. New businesses should not be sponsored by this program because the pollution control installation financed by the program involves the installation of such specialized equipment that recovery from defaults are predictably almost impossible. Also, the guarantees in the program are funded from local and state municipal bond issues which involve direct government borrowing in the private capital market.

The writer has been unable to establish the amount of money which would be saved as a result of discontinuing this program.

The Surety Bond Guaranty Program - This program involves the SBA guarantee of performance bonds issued by bonding companies to small contractors. Without an SBA guaranteed bond, costs to a small contractor are often so high, as a result of conventional bonding cost, that the small contractor's bid is not competitive. Reportedly, losses have been excessive in this program and many feel that it should either be discontinued or restructured to insure sufficiently high credit standards to reduce the risk of loss. It is recommended that the guarantee of 90% of a bond be reduced to 80%. If the program is discontinued a savings of cash outlays of approximately $16,000,000 will be realized.

Development Company Loans - These loans, which are connected with the 501, 502, and 503 lending programs have previously been included under the business loan guaranty program. The most active of these programs currently is the 503 or "Certified Development Company" program. Typically, the 503 loan consists of a 10% infusion by the borrower, a 50% funding from a bank, and 40% from a debenture which is guaranteed by the SBA and issued through the Federal Financing Bank. Loans done in this program are usually secured by real estate and/or fixed assets. The bank, which provides 50% of the funding of a 503 loan, is given a first lien on all assets taken as collateral. The SBA's 40% debenture brings up the tail end of the funding and is the most exposed part of the loan. This program is relatively young and has undergone numerous changes. Many of us anticipate considerable losses to the SBA in this program as a result of the poor lien position held by SBA relative to collateral.

It is also felt that the 503 program duplicates in many respects the general business loan made under the 7(a) guaranteed lending program. The only major difference is that a much larger loan, approximately 1.2 million dollars, can be made in the 503 program vs. the smaller loan of approximately $550,000.00 which can be made under the 7(a) program.

It is recommended that the 503 program be retained unless sufficient budget cuts cannot be achieved without its elimination. If the program is retained, its use and direction need to be re-examined. The 501 and 502 programs have been relatively inactive and should be terminated.

The Small Business Investment Company Program (SBIC) - SBIC's are currently proposing their own capital bank coupled with self-regulation. The SBIC program has been one of the most successful programs involving a partnership between the government and private sector. Direct revenues to the government far outweigh the cost of the program to the taxpayer. Favorable consideration should be given to the formation of the proposed capital bank for SBIC's and MESCIC's. Currently SBIC's are funded through debentures raised in the public marketplace by the Federal Financing Bank. Formation of the proposed capital bank will "privatize" the capital raising process for the SBIC program. However, this conversion will take two years to accomplish. The program should be supported with government funding until the conversion to the private sector is completed.

Minority Small Business and Capital Ownership Development - This program was budgeted for approximately $22,000,000 in 1984 and involved the employment of some 325 people. Most of us in the field who have day-to-day contact with the world of small business financing recognize the very vital need for long-term capital on the part of minority businesses. We also recognize the importance of the promotion of minority business ownership. In a perfect world, where ample funding were readily available, this writer would fully support most of the minority business ownership programs currently being administered by the SBA. However, given the need to reduce expenditures, it is necessary to look at programs which are in reality in their infancy, because such programs are usually more expensive in their early formative stages.

One of the programs which falls into this category is the 7(j) program, a portion of which is used to assist what are called 8(a) program firms. The 8(a) program firms are minority businesses which participate in the government contracts set-aside program. In the 8(a) program an SBA official is placed on a military or a governmental installation and acts as a primary contractor. The SBA takes down certain government contracts and then passes them on to selected minority enterprises. From a practical standpoint, the problem with this program has been the necessity of the SBA to literally create businesses in many instances for the fulfillment of government contracts. As is the case with many programs, there has also been a certain amount of abuse, with one of the primary problems being overqualified firms owned by minorities participating in the program even though those same firms could compete in the open marketplace without special consideration or treatment.

It is anticipated that losses in this program are going to be considerable since in many instances the SBA literally goes out and purchases epuipment and supplies neccessary for the minority business to complete the government contract it has been awarded. This part of the Business Development Program[4] has come under the heading of Business Development Expense (BDE). In fiscal year 1984 there were an estimated 4900 contracts awarded under the 8(a) program and approximately $20,000,000 was anticipated for BDE expense. It is recommended that BDE expense be cut 50% to $10,000,000 for the next fiscal year. This program should continue, but a pause in growth is needed to evaluate the program and make necessary changes.

The Office of Capital Ownership Development - Has responsiblity for providing guidance and control for the agency's minority programs excluding the section 8(a) program. This department was budgeted for $12,500,000 with 56 positions allocated to it. It is felt that this particular program needs to take a cut of approximately $6,000,000 for the present.

All in all, Small Minority Business Capital and Ownership Development involves 325 personnel. It is difficult to determine the total budget for all the programs involved, but it appears to be approximately $52,000,000. If the above recommendations were adopted, a savings of approximately $20,000,000 would be realized.

General Counsel, Hearings and Appeals, and Congressional and Legislative Affairs - These three agencies employ a total of 358 employees.

It is felt that these three departments can be combined into one and that their total budget of approximately $13,500,000 can be reduced by approximately $6,000,000, primarily through reduction in personnel resulting from reduced program activity throughout the SBA.

Inspector General - This division of SBA employs approximately 130 people with a budget of approximately $6,000,000. Again, with reduced program levels it should be possible to reduce this agency sufficiently to achieve at least a $1,500,000 savings.

Advocacy - Advocacy has received considerable support throughout the small business community at both the Washington and local levels. Those of us in the field also support the idea of having an advocate for small business in government. However, many of us wonder why this office is held by an attorney as a "chief counsel" when SBA already has a division for legal matters. Additionally, this office includes the Office of Interagency Affairs, the Office of Economic Research, and the Office of Information. It is possible that some restructuring and redirection is needed in the Office of Advocacy. The budget of $5,300,000 seems reasonable and no reduction in expenditures is recommended for this office.

Overall Restructuring of SBA Regional Office System - Like any agency or business which has been in existence for approximately 30 years, the SBA may have become somewhat over-organized and over-manned. The SBA currently employs nationwide approximately 4000 people and has a personnel budget of approximately $250,000,000. Additionally, SBA has 10 regions, 67 district offices, 20 branch offices, and 19 post of duty offices. Assuming a "bare bones" approach to the organizational structure of the SBA, the following recommendations are made:

A. The number of SBA regions would be reduced from 10 to 5 with the surviving regions being located in New York City; Atlanta, Georgia; Dallas, Texas; Denver, Colorado; and Los Angeles, California.

B. All Branch Offices and Post of Duty Offices should be eliminated. With a reduction in program activity and with the movement toward placing more responsiblity on lenders for loan origination and servicing, these cuts can be accomplished without much difficulty. With today's modern communications network, lenders can communicate rapidly with more removed District Offices, and many of these outposts are really no longer necessary.

C. The reduction by at least 10% or 15% of the number of District Offices throughout SBA. It should be possible to accomplish such a reduction as a result of program reductions and restructuring. However, the writer cannot provide sufficient detail in the area of District Office elimination due to a lack of information about the operation of each district.

Other Considerations. - One of the most ludicrous proposals emanating from Mr. Stockman's OMB is the "proposal" to sell the SBA's loan portfolio for something like 18¢ to 20¢ on the dollar. Such a proposal makes absolutely no sense. In a worst case scenario SBA will collect approximately 80% of its loan portfolio. The loan portfolio administered by the SBA currently approximates something like $10 billion. Assuming an interest rate of 6%, the interest on this loan portfolio should approximate $600 million a year. Additionally, recovering 80% of the portfolio instead of selling it for 20% of value results in $8 billion instead of $2 billion. Perhaps this writer is missing something, but the proposal of OMB to save approximately $5.6 billion over three years by not having the SBA in operation is offset by the loss of some $6 billion in portfolio values as a result of the 20¢ on the dollar sale of the portfolio. Then, if one takes into account the interest earned on the loan portfolio (which is lost if sold) additional revenues of 400-600 million dollars should be realized. Somehow, the proposal to abolish the SBA and sell off it's loan portfolio as recommended just does not make any sense.

It has been difficult to ascertain what actual savings could result from some of the recommendations which have been presented because, frankly, interpretation of budget dollar and program levels has been difficult. Also, it would appear that there has been some confusion among those proposing various changes in the SBA program as to the difference between budget authority, budget outlays, and the actual cost of running the SBA. In reading the SBA's proposal for fiscal year 1985, it is noted that the SBA requested 569.1 million in budget authority and 353.7 million in outlays. It looks as though the difference in budget authority and outlays resulted from a net inflow of funds from the disaster loan fund of approximately $213,000,000.

It seems to this writer, however, that there is a difference between the dollars which must be laid out on an annual basis to support an activity and what that activity actually costs. From SBA's 1985 budget data the writer tried to ascertain the difference between direct revenue to all of SBA's programs and all direct expense relative to all of SBA programs. The conclusions follow:

Salaries and Related Cost	-	($262,680,000)
Net losses from the Business and Investment Fund	-	($665,000,000)
Net losses from the Disaster Loan Fund	-	($108,957,000)
Net losses from the Lease Guaranty Revolving Fund	-	($ 1,100,000)
Net losses from the Surety Bond Guaranty Revolving Fund	-	($ 15,285,000)
Net Gain from the Pollution Control Equipment Guaranty Revolving Fund	-	$ 7,900,000
Total Loss		($1,045,122,000)

At first glance the $1 billion loss figure looms quite large. However, one critical statistic is missing from the above computations. The tax revenues generated by the several hundred thousand businesses financed over the past by SBA programs and the tax revenues of the several million people those companies employ are not included as revenue to SBA. This writer believes that the conclusion can be drawn that the SBA and the programs it administers as they exist today are already cost effective in relation to what those programs produce in revenue relative to what they cost. Even if we went along with Mr. Stockman's recommendation and sold the current SBA loan portfolio at a terrific loss, and so to speak, started the SBA over again, it would be a cost effective program without any changes, cuts or reforms.

Nevertheless, somewhere between all of this confusion over net outlays, budget authority, and net operating loss, the congress must come up with reductions in budget dollars for the SBA and the programs it administers. In that light, the writer has proposed below (in general terms and allowing for a good bit of Kentucky windage) certain reductions in budget dollars.

Elimination of nonphysical disaster loans	$100,000,000
Elimination of Direct Loan Programs	$180,000,000
Reduction in Salaries and Related Expenses	$ 50,000,000
Reduction in other programs	$ 50,000,000
Total Reductions in Budget	$380,000,000

The writer believes that enough choices for budget reductions have been presented in this paper to allow for these cuts without seriously damaging SBA's mission. Again, it should be noted that no proposals for increase in program revenues has been proposed which would increase borrower costs. However, various educational and managerial assistance programs administered for the small business community in general should be tuition programs, not so much to produce revenue, but to give those programs added value to those who participate.

Summary - The writer has proposed budget cuts and program changes because the continuation of the SBA is vital to the small business community and a good investment for the American taxpayer. Recently, a banker from a small town in Connecticut in a letter to President Reagan related that his bank had a portfolio of 100 SBA guaranteed loans totaling approximately $10,000,000. He then provided a profile of the economic impact of the businesses financed by the bank's portfolio as follows:

Gross Sales	-	$50 Million +
Number of Employees	-	1600
Federal Taxes Paid (businesses only)	-	$ 1 Million +

If the SBA and the private lenders which participate in SBA loan and investment programs currently have over 417,000 loans outstanding, and if the above bank's 100 loans provide an accurate profile of the typical SBA borrower, then those 417,000 loans produce the following results:

Gross Sales	-	$208,500,000,000
Number of Employees	-	6,672,000
Federal Taxes Paid (businesses only)	-	$ 4,170,000,000

Those 6,672,000 folks employed by businesses with SBA loans probably pay some sort of federal income tax. Suppose each employee only paid $1,000 in federal income tax. The result would be an additional $6,672,000,000. If the writer's math is correct, a program that costs $1,000,000,000 a year produces tax revenues of more than $10,000,000,000 per year. Reducing the cost of SBA may make sense. Participation by SBA in reducing the federal deficit may make sense. Eliminating the SBA does not make any sense at all.

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STATEMENT

OF

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Director of Government Relations

VIETNAM VETERANS OF AMERICA

Before the

Committee on Small Business

United States Senate

February 28, 1985

Mr. Chairman, Vietnam Veterans of America is grateful to you for the opportunity to submit a statement of our views in regard to S.408 and the U.S. Small Business Administration's programs for fiscal years 1986, 1987 and 1988. As you know, Vietnam Veterans of America (VVA) is a national not-for-profit veterans service organization exclusively devoted to Americans who served in the United States Armed Forces during the Vietnam war.

Mr. Chairman, Vietnam Veterans of America is unequivocally committed to the preservation of the U.S. Small Business Administration as an independent agency, with a strong veterans program. We deplore the oblique and improper manner in which the Reagan Administration has tried to subvert the Small Business Administration. We hope, Mr. Chairman, that this Committee and the Congress will take this opportunity to provide a clear mandate to the Small Business Administration, and a more precisely drawn mission.

Mr. Chairman, it would be useful to recount a bit of the history of the current veterans program at the Small Business Administration. In 1974, the Congress passed Public Law 93-237, which provided for "special consideration" for veterans at the Small Business Administration. The difficulty was that there was no precise definition of what "special consideration" meant, so we embarked upon seven years of sound and fury signifying nothing except wasted energy, as the veterans organizations, the SBA, and others tried to reach a definition acceptable to all concerned. In 1981, at the prompting of James Bourie, Director of Economics of The American Legion, the Small Business Administration formed the "Administrator's Task Force on Special Consideration for Veterans" chaired by Frank Swain, Special Counsel for Advocacy at the SBA. As a result of this group's work, the Administrator issued an order in May of 1982 which at long last, implemented P.L. 93-237. At the beginning of FY '83, the SBA established a permanent Office of Veterans Affairs, directed by the late Stephen Mollett. Both Administrator James C. Sanders and Associate Deputy Administrator for Special Programs Marshall Parker have given full support to this office and its work.

In fiscal year 1984 approximately one hundred thousand (100,000) veterans received management assistance training and counselling services under the aegis of the Small Business Administration. Over 15,000 veterans participated in 30 special "Veterans Business Training and Networking Conferences" held at sites across the country, ranging from Hartford, Connecticut to Nashville, Tennessee to San Diego, California. This management assistance and training is in fact the heart of the matter for most Vietnam and disabled veteran entrepreneurs or would be entreprenuers. VVA believes that most small businesses fail due to poor management, and that, if afforded the proper opportunity to equip themselves with vital business skills, veterans have the drive and tenacity to succeed in small business in great numbers. Specifically, we are speaking of "hands on" training in how to write and use a business plan, a variable cash flow analysis, a marketing plan, and other vital business skills.

The SBA is currently in the process of establishing a "Veterans Business Resource Council" (VBRC) in each District

Office. Each VBRC consists of key personnel from the SBA District Office, representatives from the veterans service organizations, representatives from other business organizations and academic institutions, and interested individual business persons who are veterans. The key concept here is harnessing and focusing resources not within the agency. This is a difficult but achievable task.

Mr. Chairman, Vietnam Veterans of America would once again point out that the Small Business Administration served well over 100,000 veterans last year, as a result of efforts led by Administrator Sanders and the veterans organizations. In the behind-the-scenes effort to end the life of the SBA the Reagan Administration has directed how all "vital" programs would be transferred or administered. VVA does not believe that it is any accident that the veterans program was not one of the 'vital' programs ostensibly provided for in the Administration's plans. The fact that David Stockman and OMB would once again try to destroy an important and vital program for the benefit of Vietnam and disabled veterans is in fact consistent with past behavior. This same group has tried in the past to destroy the VET CENTERS, the Emergency Veterans Job Training Act, the VA Home Loan Mortgage Guaranty Program, and virtually every other program that assists those of us who served during Vietnam to re-enter the American mainstream and productively contribute to America's future. The Congress thwarted most of such attempts over the last four years. We trust that, with your leadership, Mr. Chairman, and that of the Committee, this attempt will also fail and that SBA will be preserved, with an even stronger veterans program.

Mr. Chairman, although Vietnam Veterans of America feels strongly that Management Assistance and Training is central to what SBA can do and is doing for our nation's veterans, we by no means wish to diminish the importance of direct and guaranteed loans and of the Surety Bond Guarantee programs, among others. Frankly, Mr. Chairman, we would urge you and your colleagues to examine the Administration's supposed statistics very carefully in regard to the various loan programs at SBA. It is our contention that these recent portrayals of the loan programs as a debacle are simply not true. The loan programs are in fact well administered under the leadership of James Sanders.

In fact, the default rate of SBA direct and guaranteed loans for the last few years is less than two percent (2%). This would be a fully acceptable (if not enviable) loss rate for almost any commercial bank. For instance, 133 loans were made specifically under P.L. 97-72 to Vietnam era and disabled veterans in FY'83, for a total of $8.4 million dollars; the default rate to date is only 1.52%, with only $190,000 being charged off as uncollectable. In FY'84 294 such loans were approved and $14.1 million disbursed, of which only 0.64% defaulted. Thus, out of almost $25 million lent under this program in the past two and one half years, the default rate is just about 1%.

Vietnam Veterans of America would also point out, Mr. Chairman, that the SBA has a similarly solid record on all direct loan funds in the past few years. For direct loans made in FY'83, the default rate is only 0.98% to date. For guaranteed loans made in FY'83, the default rate is only 0.21%. The cost to the Federal Government for these few bad debts is about $5.5 million-less than the cost of conducting the war in Vietnam for one day. VVA would point out Mr. Chairman, that over 26% of all direct and guaranteed loans went to veterans in FY'84, or almost $700 million dollars. This is money well invested, as the low default rates indicate. Furthermore, these funds help fuel, in a significant way, the engine of prosperity that will truly assist any veteran to fully readjust into the mainstream of American society. If one wants to make a long term difference in Vietnam and disabled veterans' employment rates, then assisting veterans to acquire the tools and capital to go into business is the way to do it. Veterans tend to hire other veterans; it's just as simple as that.

In summary, Mr. Chairman, Vietnam Veterans of America urges you and this committee to preserve the Small Business Administration as a viable independent program. In addition we would urge you to reflect seriously before you drastically reduce the loan program. We believe it is a sound investment, which constitutes more than 30% of the long term capital available to small businesses in the United States. The loan program, while in our view secondary to the management assistance and small business development assistance functions of SBA, provides a vital infusion of investment capital in our nation's future. VVA urges you not to mortgage that future on the basis of the specious arguments and doubtful numbers from provided by the Administration.

TESTIMONY IN SUPPORT OF THE SMALL BUSINESS ADMINISTRATION

BY

PAUL DUNN, PAST PRESIDENT
SMALL BUSINESS INSTITUTE DIRECTORS ASSOCIATION

NORTHEAST LOUISIANA UNIVERSITY
SMALL BUSINESS DEVELOPMENT CENTER
MONROE, LOUISIANA 71209

LADIES AND GENTLEMEN OF THE SENATE SMALL BUSINESS COMMITTEE:

THANK YOU VERY MUCH FOR THIS OPPORTUNITY TO SPEAK TO YOU FOR A FEW MINUTES IN SUPPORT OF THE CONTINUATION OF THE SMALL BUSINESS ADMINISTRATION, AND IN PARTICULAR, ITS PROGRAMS SUCH AS THE SMALL BUSINESS INSTITUTE.

BACKGROUND

AS I UNDERSTAND IT, THE ORIGINAL PURPOSE OF THE AGENCY WAS TO AID THE U.S. IN A TRANSITIONAL ECONOMY AFTER WORLD WAR II AND THE KOREAN CONFLICT BY FOCUSING SUPPORT TO THE SMALL BUSINESS SECTOR. IN THAT CONTEXT, THE AGENCY PROVIDED FUNDS TO HELP AS THE ECONOMY SHIFTED TO CONSUMER MANUFACTURING AND DISTRIBUTION FROM EXTANT WAR PRODUCTION.

IN TIME, EXPERIENCE SHOWED THAT THE PROVISION OF FINANCING FOR SMALL BUSINESS WAS ONLY PART OF THE JOB. THE PROBLEM WAS THAT MANY AGENCY CLIENTS WERE HAVING MANAGEMENT DIFFICULTIES BEYOND THE NEED FOR FUNDS. TO PROVIDE MORE COMPLETE SUPPORT FOR SMALL BUSINESS THE AGENCY BEGAN TO DEVELOP ITS MANAGEMENT ASSISTANCE DIVISION THAT CONTINUES TODAY THOUGH IN A MUCH MORE DEVELOPED FORM.

ACCORDING TO DUN AND BRADSTREET, THE MOST COMMON CAUSES OF FAILURE AMONG BUSINESSES ARE MANAGEMENT FAILURES. TO REDUCE THOSE FAILURES, IT IS NECESSARY TO PROVIDE THE NEW OR GROWING SMALL BUSINESS WITH SOME TYPE OF MANAGEMENT AND/OR TECHNICAL ASSISTANCE THROUGH EITHER THE PRIVATE OR PUBLIC SECTOR. SINCE MOST BEGINNING SMALL BUSINESSES ARE STRAPPED FOR

FUNDS TO MAINTAIN A GOING CONCERN AND GROW IN AN ORDERLY WAY, THE MANAGEMENT ASSISTANCE PROGRAMS OF THE SBA HAVE FILLED AND CONTINUE TO FILL A NEED THAT CANNOT BE FILLED BY THE PRIVATE SECTOR EITHER BECAUSE THE SERVICES ARE NOT AVAILABLE OR THE COST IS BEYOND THE MEANS OF MANY OF THESE BUSINESSES.

EVOLUTION OF THE SMALL BUSINESS INSTITUTE PROGRAM.

THE SBA BEGAN FUNDING THE SBI PROGRAM THROUGH A PILOT PROGRAM CONDUCTED AT TEXAS TECH UNIVERSITY IN 1972. DR. ROBERT KERBER (A GRADUATE STUDENT AT THAT TIME AND CURRENT PRESIDENT OF THE SMALL BUSINESS INSTITUTE DIRECTORS ASSOCIATION) WAS INVOLVED IN THE ORIGINAL PILOT PROJECT. THE HYPOTHESIS BEHIND THE PROJECT WAS THAT A VALUABLE RESOURCE WAS AVAILABLE TO THE AGENCY WHICH COULD PROVIDE QUALITY MANAGEMENT AND TECHNICAL ASSISTANCE AT A VERY LOW COST USING STUDENT CONSULTANTS UNDER FACULTY SUPERVISION. THAT HYPOTHESIS WAS CORRECT. BASED ON THE SUCCESS OF THAT PILOT PROGRAM THE AGENCY DECIDED TO CONTRACT WITH OTHER UNIVERSITIES TO DELIVER MANAGEMENT ASSISTANCE TO SMALL BUSINESS ADMINISTRATION PORTFOLIO CASES.

SINCE THAT DATE, THE SMALL BUSINESS INSTITUTE HAS PROVIDED QUALITY COUNSELING AND CONSULTING TO APPROXIMATELY 120,000 CLIENTS USING 250,000 STUDENTS SUPERVISED BY 15,000 DEDICATED FACULTY. THIS PROGRAM SUITS THE TEACHING MODE OF THOSE US WHO BELIEVE THAT AT LEAST A PART OF A COLLEGE OF BUSINESS ADMINISTRATION DEGREE SHOULD BE SPENT IN THE BUSINESS WORLD TESTING AND APPLYING THE THEORIES AND CONCEPTS DEVELOPED IN THE CLASSROOM.

IN 1973, THE SMALL BUSINESS INSTITUTE INVOLVED THIRTY-SIX SCHOOLS, 1,360 CASES, PROBABLY 3,500 STUDENTS, AND 108 FACULTY MEMBERS. THE PROGRAM GREW RAPIDLY IN THE FIRST FOUR OR FIVE YEARS TO INCLUDE 405 SCHOOLS. IN THE CURRENT YEAR, THE PROGRAM INCLUDES 508 SCHOOLS, AN EXPECTED 7,500 CASES (BASED ON THE CURRENT BUDGET FOR THE PROGRAM), CLOSE TO 19,000 STUDENTS, AND 1,500 FACULTY SUPERVISORS. INCIDENTALLY, MOST OF THESE FACULTY HAVE BUSINESS AND INDUSTRY OR CONSULTING EXPERIENCE, A BACKGROUND THAT IS THE PRIMARY REASON FOR THEIR DESIRE TO HAVE THEIR STUDENTS INVOLVED IN SUCH PROJECTS.

WHILE STATISTICS ARE NOT AVAILABLE TO PROVE THE ACTUAL NUMBER OF CASES DONE, MANY CASES ARE DONE OUTSIDE THE CONTRACT DUE TO THE DEMAND BY CLIENTS FOR THE SERVICE AND BY STUDENTS FOR PARTICIPATION IN THIS PROGRAM. THIS HIGH DEMAND OFTEN OUTSTRIPS THE AGENCY'S FUNDING LEVEL.

IN MY OWN CASE, OUR FACULTY AND STUDENT TEAMS DO FROM TWENTY TO THIRTY PERCENT MORE CASES THAN CONTRACTED FOR DEPENDING ON THE AVAILABILITY OF STUDENT COUNSELORS IN A PARTICULAR SEMESTER. I SUSPECT THAT THIS IS DONE IN MANY SCHOOLS.

THE SBI EVALUATION STUDIES DONE BY MARK WEAVER AND GEORGE SOLOMON CLEARLY INDICATE THAT THE CLIENTS OF THE SBI PROGRAM ARE PLEASED WITH AND PROFIT FROM THE RESULTS OF THE STUDENTS' WORK. THESE STUDIES, DONE BETWEEN 1981 AND 1984, WERE RECENTLY PUBLISHED IN SUMMARY FORM IN THE 1985 SBIDA CONFERENCE PROCEEDINGS. OF COURSE, ALL STUDENT PROJECTS ARE SUPERVISED BY FACULTY MEMBERS WHOSE NAMES ARE ATTACHED TO THE FINAL

CONSULTING REPORTS AND WHO VALUE THEIR REPUTATIONS IN THE UNIVERSITY AND BUSINESS COMMUNITY. THIS HELPS INSURE THAT THE PROJECTS ARE DONE WELL.

SOME HAVE BEEN CRITICAL OF THE SBI PROGRAM BECAUSE OF THE POOR PERFORMANCE OF SOME OF OUR CLIENTS. YOU MUST REALIZE THAT WE ARE EXPECTED TO DEAL WITH MANY PORTFOLIO CASES WHICH ARE "BASKET CASES" WHEN THEY COME TO US. IN MANY WAYS, MY JOB WITH THE SBI WAS, IN THE PAST, LIKE WORKING IN THE TERMINAL WARD OF A HOSPITAL. I AM PLEASED TO SAY, HOWEVER, THAT OUR SUCCESS RATE IS IMPROVING. THIS IS OCCURRING BECAUSE WE ARE IDENTIFYING THE POTENTIAL PROBLEM CASES EARLIER, SBI ASSISTANCE HAS GAINED A REPUTATION AS A GOOD SOURCE OF VALUABLE HELP AND CLIENTS SEEK ASSISTANCE EARLIER, AND BECAUSE WE ARE DEALING WITH A BROADER SPECTRUM OF CASES THAN PREVIOUSLY. MANY OF OUR CURRENT CLIENTS NOW WANT ASSISTANCE IN ASSESSING OPPORTUNITIES FOR GROWTH RATHER THAN OUR HELP AS THEY GO BANKRUPT.

THESE CHANGES HAVE RESULTED IN MUCH MORE POSITIVE RESULTS IN THE COMMUNITIES WE SERVE. IN FACT, RECENT DEVELOPMENTS IN THE PROGRAM HAVE INVOLVED THE SMALL BUSINESS INSTITUTE IN COMMUNITY ECONOMIC DEVELOPMENT PROJECTS. THE ONARGA PROJECT COMPLETED BY SEVERAL STUDENTS UNDER THE DIRECTION OF BOB KERBER IN ILLINOIS OFFERS GRAPHIC PROOF OF WHAT STUDENT TEAMS UNDER GOOD FACULTY SUPERVISION CAN DO FOR ENTIRE COMMUNITIES. OTHER SCHOOLS ARE UNDERTAKING SIMILAR PROJECTS. THIS MOVEMENT, AS WELL AS THE MOVEMENT OF THE AGENCY TO ALLOW THE USE OF NON-PORTFOLIO CASES AND MORE SUCCESSFUL PORTFOLIO CASES AS SBI CASES, INDICATES THE AGENCY'S WILLINGNESS TO RESPOND TO LOCAL SITUATIONS BY WORKING MORE CLOSELY WITH SBI DIRECTORS AND DISTRICT OFFICE PERSONNEL. TOO, THESE PROJECTS ARE

TESTIMONY THAT COMMUNITIES RECOGNIZE THIS RESOURCE AS A VALUABLE TOOL IN ECONOMIC DEVELOPMENT.

THIS RECOGNITION EXTENDS TO THE STATES WHERE STATE OFFICIALS ARE NOW ENCOURAGING THE USE OF STUDENT AND FACULTY RESOURCES IN ECONOMIC DEVELOPMENT. THE SMALL BUSINESS INSTITUTE AND THE SMALL BUSINESS DEVELOPMENT CENTERS (WHERE THEY EXIST), HAVE BEEN RECOGNIZED AS VALUABLE RESOURCES IN HELPING SMALL BUSINESSES GET STARTED, PROSPER, AND GROW IN AN ORDERLY WAY. IN LOUISIANA, FOR EXAMPLE, RESOURCES ARE BEING COMMITTED TO AN INDIGENOUS INDUSTRY PROGRAM WHICH USES THESE RESOURCES AS PART OF THE STATE DEVELOPMENT PROGRAM. NO LONGER ARE WE IN LOUISIANA CONTENT TO SEE MONEY SPENT "CHIMNEY CHASING"--WE ARE "GROWING OUR OWN" AND THE SMALL BUSINESS ADMINISTRATION PROGRAMS ARE PART OF THAT EFFORT.

WHILE SOME DETRACTORS ASSERT THAT STUDENTS AND EGGHEAD PROFESSORS CANNOT GIVE GOOD MANAGEMENT ASSISTANCE AND OTHERS INSIST THAT THE SBI PROGRAM COMPETES WITH PRIVATE SECTOR CONSULTANTS, MY EXPERIENCE IS QUITE DIFFERENT. MANY OF THE CLIENTS WHO ASK FOR THE SERVICES OF THE SMALL BUSINESS INSTITUTE PROGRAM ARE REFERRED TO THE PROGRAM BY PRIVATE SECTOR ADVISORS INCLUDING BANKERS, ACCOUNTANTS, LAWYERS, AND ADVERTISING AGENTS. THESE PROFESSIONAL PRIVATE SECTOR ADVISORS RECOGNIZE THAT THE CLIENT NEEDS ASSISTANCE AND CANNOT AFFORD, AT THE TIME, TO PAY THE PRIVATE SECTOR FEES OR THE NEEDED SERVICES ARE NOT AVAILABLE LOCALLY. AT THE SAME TIME, THEY RECOGNIZE THAT THE BUSINESS COULD IN MANY INSTANCES BECOME A VIABLE MEMBER OF THE COMMUNITY WITH SOME ASSISTANCE. THESE PRIVATE SECTOR ADVISORS DO NOT FEEL THREATENED BY OUR PROGRAM. RATHER THEY FEEL THAT THE MANAGEMENT ASSISTANCE PROGRAM PROVIDED BY THE

UNIVERSITY IS AN INTEGRAL PART OF THE ECONOMIC DEVELOPMENT ACTIVITIES IN THEIR AREA AND THAT UNIVERSITIES THEMSELVES ARE A PART OF THE BUSINESS COMMUNITY.

THE SUPPORT OF THE NATIONAL AND LOCAL CHAMBERS OF COMMERCE AND THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS ARE CLEAR INDICATIONS THAT THE SMALL BUSINESS INSTITUTE PROGRAM IS A VALUABLE ONE WHICH SHOULD BE RETAINED. I WOULD LIKE TO TAKE THIS OPPORTUNITY TO THANK MR. SLOAN FOR HIS KIND REMARKS ABOUT THE SBI PROGRAM IN HIS TESTIMONY TO THIS COMMITTEE.

FINALLY, THERE ARE TWO POSITIVE OUTCOMES OF THE SMALL BUSINESS INSTITUTE PROGRAM THAT MUST NOT BE OVERLOOKED. THESE ARE THE INCREASED NUMBER OF COURSES BEING TAUGHT AT THE GRADUATE, UNDERGRADUATE, AND JUNIOR COLLEGE LEVEL IN COLLEGES THROUGHOUT THE NATION WHICH ARE A DIRECT RESULT OF THE SMALL BUSINESS INSTITUTE PROGRAM. AT NORTHEAST LOUISIANA UNIVERSITY WHERE I TEACH, WE OFFER, AS A DIRECT RESULT OF THE SBI PROGRAM, THREE COURSES IN SMALL BUSINESS AND ARE PREPARING TO INSTALL ANOTHER IN ENTREPRENEURSHIP. THESE COURSES ARE VERY POPULAR AMONG STUDENTS AS ELECTIVE COURSES. STUDENTS INDICATE THAT THESE COURSES ALLOW THEM TO USE THEIR CLASSROOM KNOWLEDGE IN VERY MEANINGFUL WAYS. IN FACT, SOME STUDENT COUNSELORS GO ON TO BECOME EMPLOYEES OF THEIR FORMER CLIENTS OR OWNERS OF THEIR OWN FIRMS.

ANOTHER VERY POSITIVE OUTCOME OF THIS PROGRAM HAS BEEN AN INCREASED INTEREST AMONG COLLEGE OF BUSINESS STUDENTS IN CAREERS AS SMALL BUSINESS PEOPLE. THIS HAS BEEN ONE OF THE MOST REWARDING EXPERIENCES FOR ME AS A

TEACHER. IN THE TWENTY-FIVE PLUS YEARS THAT I HAVE TAUGHT, ONLY RECENTLY HAVE STUDENTS IN SUBSTANTIAL NUMBERS BEGUN TO TALK OF CAREERS AS SMALL BUSINESS PEOPLE. THIS CAN ONLY BODE WELL FOR THE ECONOMIC FUTURE OF OUR NATION. WHILE THE SBI PROGRAM WAS CONCEIVED AS A MANAGEMENT ASSISTANCE MECHANISM FOR BUSINESS BY THE SMALL BUSINESS ADMINISTRATION, THE EFFECT ON THE STUDENTS CANNOT BE OVERLOOKED.

I HAVE TAKEN THE LIBERTY OF BRINGING EACH OF YOU A COPY OF THE BROCHURE DESCRIBING THE SBI PROGRAM AT MOST SCHOOLS.

IN MY JUDGMENT, THE SMALL BUSINESS INSTITUTE PROGRAM IS ONE OF THE BEST MARRIAGES BETWEEN THE PUBLIC AND PRIVATE SECTORS EVER CONCEIVED. THE SERVICE CORPS OF RETIRED EXECUTIVES (SCORE) VOLUNTEER WHO WORKS WITH ME IN MY SBI CASES, MR. MILES SAGER, SAYS THAT THE SBI IS THE BEST WIN-WIN PROGRAM HE KNOWS. THE SBA RECEIVES QUALITY MANAGEMENT ASSISTANCE FOR SMALL BUSINESSES FROM KNOWLEDGEABLE STUDENTS SUPERVISED BY SKILLED AND EXPERIENCED FACULTY (AND I MIGHT ADD WITH SCORE PEOPLE ASSISTING IN MANY SCHOOLS) AT A COST THAT IS SMALL INDEED COMPARED TO THE VALUE RECEIVED. THE DEMISE OF THE PROGRAM THEN WOULD BE A LOSS-LOSS SITUATION.

THE DEMISE OF SBA WOULD RESULT IN THE DEMISE OF SBI. I HAVE SPOKEN TODAY ALMOST EXCLUSIVELY OF THE SBI PROGRAM BUT I DO WANT TO VOICE MY SUPPORT FOR SBA AS A WHOLE. CLEARLY, AS AN SBI DIRECTOR I HAVE A VESTED INTEREST IN THE CONTINUED SURVIVAL OF THE AGENCY. IT IS MY FIRM BELIEF THAT THE SMALL BUSINESS COMMUNITY NEEDS A DEDICATED VOICE IN OUR GOVERNMENT. THE INDEPENDENCE OF SBA IS CRUCIAL TO THE FULFILLMENT OF THIS ROLE.

THOUSANDS UPON THOUSANDS OF BUSINESSES ARE PROSPERING TODAY, PAYING TAXES, EMPLOYING AMERICANS, AND PROVIDING GOODS AND SERVICES TO THE COUNTRY AS A RESULT OF SBA PROGRAMS, SERVICES, AND LOANS. IN A VERY REAL SENSE, THESE FIRMS ARE REPAYING THE COUNTRY FOR THE HELP SBA PROVIDED THEM WHEN MERE SURVIVAL WAS THEIR DREAM. WE SBI DIRECTORS TAKE GREAT PRIDE IN HAVING BEEN A PART OF THIS EFFORT.

YOU LADIES AND GENTLEMEN IN THE SENATE ARE IN A UNIQUE POSITION TO HELP SALVAGE A VALUABLE PROGRAM--THE SMALL BUSINESS INSTITUTE. I CHALLENGE YOU TO DO SO!

ON BEHALF OF THE 508 SMALL BUSINESS INSTITUTE DIRECTORS AROUND THE COUNTRY AND SMALL BUSINESS INSTITUTE DIRECTORS ASSOCIATION, THANK YOU FOR YOUR TIME AND ATTENTION.

Paul Dunn
PAUL DUNN, PAST PRESIDENT
SMALL BUSINESS INSTITUTE DIRECTORS ASSOCIATION

NORTHEAST LOUISIANA UNIVERSITY
SMALL BUSINESS DEVELOPMENT CENTER
MONROE, LOUISIANA 71209

GOODWILL INDUSTRIES
OF AMERICA, INC.

EXECUTIVE OFFICES • 9200 WISCONSIN AVENUE • BETHESDA, MARYLAND 20814-3896 • 301/530-6500

Statement of

GOODWILL INDUSTRIES OF AMERICA, INC.

Before the

Committee on Small Business

U.S. Senate

on the

Reauthorization of the Small Business Administration

February 28, 1985

Goodwill Industries of America, Inc. (GIA) appreciates this opportunity to submit testimony in support of legislation (S.408) to reauthorize Small Business Administration (SBA) programs and activities.

GIA is a national nonprofit membership organization serving individuals with disabilities through 175 rehabilitation facilities in North America and 44 affiliates in 31 countries around the world. These community-based organizations provide a wide variety of services to people with handicaps, including job training, vocational evaluation, transitional and full-time employment, independent living skills, career counseling, and private sector placement services.

We are the largest network of privately operated vocational rehabilitation facilities in the world. More than 71% of our revenues last year were derived from retail sales and industrial contracts for goods and services. These revenues, along with fees earned by providing services for government rehabilitation agencies and with limited public contributions, are used to provide vocational rehabilitation programs and employment for individuals with disabilities. In 1983, Goodwill Industries placed 7,500 people with handicaps into competitive, private sector employment through our placement programs, and employed over 28,000 workers with disabilities in our retail outlets, production facilities, and contract programs.

The Handicapped Assistance (HAL) program authorized by Section 7(a)(10) of the Small Business Act has been vital to Goodwill Industries and other organizations and small businesses employing or owned by people with disabilities. These direct loans are available under two classifications:

- HAL-1 loans are available only to nonprofit organizations employing workers with handicaps for not less than 75% of the man hours required for the production of commodities or in the provision of services.

- HAL-2 loans are available only to small businesses wholly owned by individuals with handicaps.

Loans under the HAL program may be for amounts up to $350,000 for a maximum term of 15 years.

Goodwill Industries was distressed to learn that the Office of Management and Budget has proposed the elimination of all loan programs administered by the SBA. For an Administration placing a great deal of emphasis on cost-benefit analysis, we do not understand the rationale behind this ill-advised proposal. The Chairman and Ranking Member of this Committee, along with the other original co-sponsors, should be commended for the introduction of S.408, legislation to reauthorize many important SBA programs--including Handicapped Assistance Loans--for fiscal years 1986, 1987, and 1988.

Since 1973, 71 local Goodwill members have received 93 direct loans under the HAL program in amounts ranging from $8,000 to the maximum $350,000. Goodwills have borrowed a total of $16,685,000 in HAL funds over this period, and the average loan amount has been $179,400. Goodwills utilize the loan proceeds for a variety of purposes, including:

- Facility renovation and acquisition;
- Equipment renovation and purchase;
- Debt reduction; and
- Working capital.

Of these 93 loans to Goodwills, we are proud of the fact that 92 of the loans are current in their repayment obligations to the SBA.

It is important to note that nonprofit organizations which receive HAL-1 funds must demonstrate that credit is not available from private sources or other federal, state, or local programs. The members of this Committee are well aware that small businesses often face tremendous difficulty in obtaining credit on reasonable terms from private sources. These difficulties are magnified when nonprofit rehabilitation organizations attempt to obtain credit because the assets of these organizations are many times insufficient to meet the requirements of private lending sources while many of these normal sources do not understand the operation of a nonprofit business, they are therefore unwilling to recognize that we are acceptable risks.

Without the availability of the HAL program, some of these Goodwills would have faced bankruptcy and closed their doors. Others would have been unable to expand their services to meet increased demand for vocational rehabilitation services. In both cases, the existence of the Handicapped Assistance Loan program enabled citizens with disabilities to become less reliant on federal disability programs. In 1983, we estimate wages paid to workers with disabilities employed by Goodwills totalled $96 million. The 7,500 individuals placed in private sector employment through Goodwill programs earned more than $52 million in wages. Taking into account the federal, state, and local taxes paid by these individuals, application of a cost-benefit analysis produces strong justification for the continuation of the HAL program.

It is important to note that the net cost of the HAL program to the federal government is substantially less than the appropriated amount. Loans under the HAL program are not grants, they are obligations. The real cost of the program is only the difference between HAL loans subsidized at 3% and interest rates in the open market.

The issue facing Congress is whether the increased level of social services made possible by Handicapped Assistance Loans is justified when compared to the minimal net expenditures by the federal government. When the "costs" of the program are measured against the program "benefits," the results constitute overwhelming evidence supporting the program's reauthorization.

Because Goodwills are small businesses confronting the same problems and concerns of all small firms, we recognize the budgetary restraints facing all federal programs. The success of Goodwills closely parallels the performance of the economy, and as such, we are concerned that steps be taken to reduce the federal budget deficit. As a result, we must realistically agree that funding for the HAL program should remain at $20 million for fiscal 1986, the amount authorized in S.408.

We believe that this bill represents a reasonable compromise that preserves critically important SBA programs while at the same time makes significant reductions in overall SBA spending authority. Accordingly, we urge prompt action by the Committee on Small Business and the full Senate on S.408.

Attached to this statement is a summmary of the impact of HAL program on local Goodwill Industries, along with a listing of the 71 Goodwills which have received Handicapped Assistance Loans since 1973.

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FACT SHEET

SMALL BUSINESS ADMINISTRATION

HANDICAPPED ASSISTANCE LOAN (HAL) PROGRAM

- Since 1973, 71 local Goodwill members have received 93 direct loans in amounts ranging from $8,000 to the statutory maximum $350,000. The average loan amount has been $179,400.

- Of these 93 loans to Goodwills, 92 are current in their repayment obligations to the Small Business Administration.

- Goodwills have received more than $16.6 million in HAL program proceeds, allowing them to expand vocational rehabilitation services for citizens with disabilities. Goodwill employment and private sector placement programs directly reduce reliance on federal disability entitlements.

- HAL funds are available to Goodwills and other nonprofit rehabilitation organizations only when credit is not available from private sources or other federal, state, or local programs.

- Without the availability of HAL funds, some of the Goodwills listed on reverse would have faced bankruptcy and ceased providing rehabilitation services. Other Goodwills would have been unable to meet increased community demand for services.

- In 1983, the 175 local Goodwill Industries placed 7,500 people with handicaps into competitive, private sector employment through our placement programs, and employed over 28,000 workers with disabilities in our retail outlets, production facilities, and contract programs.

(more)

GOODWILL INDUSTRIES

RECIPIENTS OF HANDICAPPED ASSISTANCE LOANS

ALABAMA
Montgomery

ARKANSAS
Little Rock

CALIFORNIA
Sacramento
San Francisco
San Jose
Santa Rosa
Stockton

COLORADO
Denver

CONNECTICUT
Bridgeport
New Haven

FLORIDA
Lakeland
Sarasota
Tallahassee
West Palm Beach

GEORGIA
Atlanta
Savannah

HAWAII
Honolulu

INDIANA
Evansville
Hammond
Indianapolis
South Bend

IOWA
Des Moines

KANSAS
Wichita

KENTUCKY
Louisville

LOUISIANA
New Orleans

MAINE
Portland

MARYLAND
Hagerstown

MASSACHUSETTS
Boston
Lowell
Springfield

MICHIGAN
Battle Creek
Flint
Kalamazoo
Muskegon
Port Huron

MINNESOTA
Duluth

MISSISSIPPI
Gulfport

MISSOURI
St. Louis

MONTANA
Great Falls

NEBRASKA
Grand Island
Lincoln

NEW JERSEY
Camden
Harrison

NEW MEXICO
Albuquerque

NEW YORK
Buffalo

NORTH CAROLINA
Charlotte
Greensboro

OHIO
Cincinnati
Cleveland
Dayton
Lima
Marion

OKLAHOMA
Lawton
Oklahoma City
Tulsa

OREGON
Portland

PENNSYLVANIA
DuBois
Lancaster
Reading

TENNESSEE
Knoxville
Memphis

TEXAS
Abilene
El Paso
San Antonio

VIRGINIA
Richmond

WEST VIRGINIA
Charleston

WISCONSIN
Marinette
Menasha
Milwaukee

WYOMING
Cheyenne

STATEMENT

OF

RONALD BEAN

PRESIDENT

COUNCIL OF POLLUTION CONTROL FINANCING AGENCIES

AND

EXECUTIVE DIRECTOR

ILLINOIS ENVIRONMENTAL FACILITIES FINANCING AUTHORITY

ON BEHALF OF THE

COUNCIL OF POLLUTION CONTROL FINANCING AGENCIES

BEFORE THE

THE SENATE COMMITTEE ON SMALL BUSINESS

U.S. SENATE

WASHINGTON, D.C.

FEBRUARY 28, 1985

Mr. Chairman, Members of the Committee, I am Ron Bean, President of the Council of Pollution Control Financing Agencies. The Council is a non-profit organization formed by local and state agencies which serve as issuers of tax-exempt financing for pollution control and solid waste facilities. The Council includes associate members from the financial, legal and industrial sectors. Council members have been active in supporting the availability of tax-exempt financing as an important part of the nation's effort to achieve environmental goals and foster economic development.

On behalf of the Council, I welcome the opportunity to provide the Committee with our views on SBA's Pollution Control Loan Guarantee Program to assist small businesses in achieving vital pollution abatement goals.

Mr. Chairman, as you and others on this Committee know so well, efforts to assist small businesses in complying with environmental laws have been consistently undermined by strong Administrative opposition to this SBA program. This systematic and continuing Administrative assault on this program, beginning December 31, 1981, places the Council and other strong supporters in a difficult position. We have not been able to add substantially to the record of achievement since 1981, given OMB's directive denying the use of guarantees for tax-exempt financed projects. The availability of tax-exempt financing is the most important tool available to assist small businesses through the SBA guarantee program.

I would like to recap briefly some of the background leading up to Committee consideration of S. 408. As I noted before the Administration issued a directive on December 31, 1981 that precluded the Small Business Administration from entering into pollution control loan guarantees commitments utilizing tax-exempt financing. At the time of this action, SBA had $250 million in FY 82 authorization and had provided guarantees on a tax-exempt basis totaling approximately $39.6 million. The Office of Management and Budget had additionally directed the SBA to limit any further guarantee commitments to $150 million with the stipulation that any new guarantees would be for taxable loans. Congress in its continuing appropriations resolution directed that this program, at a minimum, be maintained at a level of $175 million. Unfortunately, OMB maintained the freeze on tax-exempt guarantees ignoring Congress' intent and disregarding the history and purpose of this critical program.

In 1983, this Committee took the necessary action to reverse this unfortunate set of events, reporting to the Senate S. 2408, mandating the provision of Pollution Control Loan Guarantees for tax-exempt financings. Unfortunately, the Senate was unable to consider this legislation prior to the conclusion of the 97th Congress and the Administration prohibition remained in effect. This Committee again responded by strong efforts to return the guarantee program to its original purpose.

Because that effort did not succeed, many businesses have been forced to abandon efforts to finance the acquisition of pollution control equipment required to comply with the Nation's environmental mandates and regulations. Not only has the environment suffered, but the economy as well.

During this period, we learned that the Pollution Loan Guarantee for taxable financings is not a realistic option. It forced a heavier burden of pollution control financing upon the shoulders of businesses least capable of acquiring the necessary capital.

As evidence of the lack of enthusiasm for the taxable guarantee alternative as a viable option, I draw your attention to the response SBA received following its retroactive policy change concerning the termination of the tax-exempt program. SBA notified over 100 businesses to either switch to the taxable guarantee route or face withdrawal of their applications. In response just one firm out of this total notified SBA of its desire to seek a taxable guarantee. Clearly, the large majority of these companies believe, as CPCFA does, that the costs become prohibitive under the taxable guarantee option.

As you know, Congress specifically mandated tax-exempt issue guarantees in Public Law 94-305. On several occasions in 1983, Congress reconfirmed its commitment to tax-exempts and advised SBA to make these guarantees available. Despite these Congressional directives, the SBA and this Administration continues to thwart Congress' intent.

With this background, we now look to 1985 with renewed anxiety. Before this Committee is the Administration's proposal to eliminate SBA along with all of its investment programs, including the Pollution Control Loan Guarantee Program. Before the Finance Committee, we expect the Administration to pursue the elimination of all tax-exempt private activity bonds under the banner of tax reform.

Mr. Chairman, your bill, S. 408, recognizes that many of these proposals have less to do with the achievements of these programs and "true costs" to the U.S. Treasury and more to do with an overriding desire to shrink government involvement in solving important national problems. This basic tendency to flatly discount the problems small businesses confront in addressing key national economic and environmental objectives serves no national purpose.

Last October your efforts proved successful with the enactment of Public Law 94-473, specifically overriding the Administration's directive. Since that time, CPCFA members have been working with small businesses to assist their efforts to apply for FY 1985 guarantee authority. At this time, SBA is now reviewing applications as a result of the legislative changes enacted late last year.

Complicating this effort initially has been the enactment last year of the Deficit Reduction Act and its numerous changes affecting tax-exempt financing for these projects. As you know, included in these changes was the imposition of a state bond limitation on tax-exempt private activity bonds. On one hand, we have been working to get the SBA program back on track, and at the same time we must also respond to new requirements for the issuance of tax-exempt bonds to finance these important projects.

It should be emphasized that SBA's Pollution Control Guarantee Program is funded at virtually no cost to the federal government. In fact, the SBA program generates fees in excess of any direct costs to SBA. Any limited costs associated with tax-exempt financings to support these projects is an issue that will soon be considered by the Finance Committee and the Committee on Ways and Means. These costs, if any, must be weighed against positive revenues to SBA and environmental gains which are direct a result of the program. I would urge Members of this Committee to assert your interest in the debate on tax-exempt bonds for pollution control facilities and other areas of bond activity benefitting small businesses.

In my own state, I serve as Executive Director of the Illinois Environmental Facilities Financing Authority and as Executive Director of the Illinois Development Finance Authority. In both capacities, I work with IDBs and I am very familiar with the importance of this financing tool in assisting the efforts of small businesses. In Illinois, we just launched a major new initiative to provide $70 million in loans specifically designed to meet the needs of small businesses throughout the state.

Mr. Chairman, let me conclude my testimony with strong endorsement of S. 408 and its provisions to extend SBA's Pollution Control Guarantee Program through FY 1988. The level of guarantee authority will allow these important pollution control projects to continue in future years. As our members add to the record on this program throughout this fiscal year, CPCFA will share this information with the Committee to assist your future deliberations.

On behalf of CPCFA members, I appreciate this opportunity to express our views on this important program.

Toll Free (within California) (800) 542-6288
Toll Free (outside California) (800) 221-4937

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Miller & Schroeder Municipals, Inc.
505 Lomas Santa Fe Drive, Suite 100, Post Office Box 946, Solana Beach, California 92075 ● (619) 481-5894

February 22, 1985

Senator Lowell P. Weicker, Jr.
Chairman
Senate Small Business Committee
SR-428A
Washington, D.C. 20510

Attention: R. Michael Haynes
Chief Counsel

Dear Senator Weicker:

We are writing in support of S. 408 which would assure continuity for the Small Business Administration.

In particular, we feel strongly that the need to maintain the SBA's Pollution Control Financing Guarantee program is essential. Enclosed is an example of the pressure being put on small businesses.

Most industrial development financing is now undertaken with credit enhancement devices, including financial guarantees and bond insurance issued by private insurance companies.

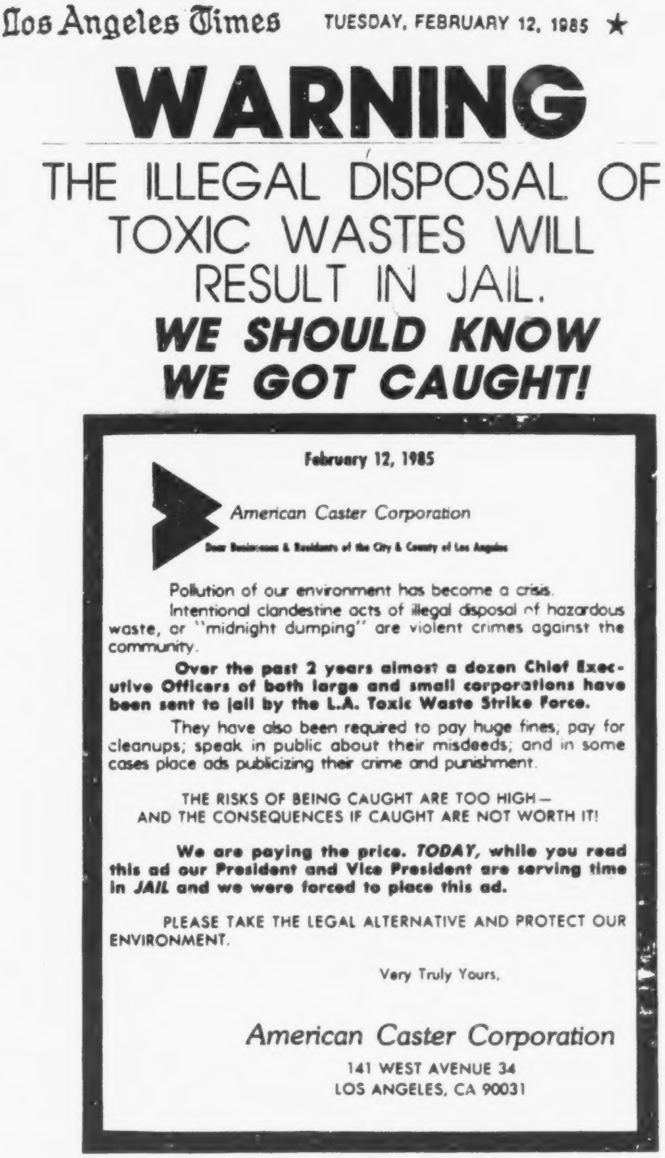
None of these can take the place or serves the purpose of the SBA's Pollution Control Financing Guarantee. It is timely and appropriate to suggest that the private sector be encouraged to participate in the risk now borne by the federal government in this program.

Also enclosed is our statement for your Committee. We regret we cannot be present for your hearings. We are too busy processing applications and loan documents for financing with the Guarantee.

Yours very truly,

James H. McCall
James H. McCall
Director of Project Finance

JHM:lj
Enclosures



Los Angeles Times TUESDAY, FEBRUARY 12, 1985 ★

WARNING

THE ILLEGAL DISPOSAL OF TOXIC WASTES WILL RESULT IN JAIL.

WE SHOULD KNOW WE GOT CAUGHT!

February 12, 1985

American Caster Corporation

Dear Businesses & Residents of the City & County of Los Angeles

Pollution of our environment has become a crisis.

Intentional clandestine acts of illegal disposal of hazardous waste, or "midnight dumping" are violent crimes against the community.

Over the past 2 years almost a dozen Chief Executive Officers of both large and small corporations have been sent to jail by the L.A. Toxic Waste Strike Force.

They have also been required to pay huge fines; pay for cleanups; speak in public about their misdeeds; and in some cases place ads publicizing their crime and punishment.

THE RISKS OF BEING CAUGHT ARE TOO HIGH—
AND THE CONSEQUENCES IF CAUGHT ARE NOT WORTH IT!

We are paying the price. *TODAY,* while you read this ad our President and Vice President are serving time in *JAIL* and we were forced to place this ad.

PLEASE TAKE THE LEGAL ALTERNATIVE AND PROTECT OUR ENVIRONMENT.

Very Truly Yours,

American Caster Corporation
141 WEST AVENUE 34
LOS ANGELES, CA 90031

FULL PAGE ON LAST PAGE OF BUSINESS SECTION

Miller & Schroeder Municipals, Inc.

THE SBA'S POLLUTION CONTROL FINANCING PROGRAM:

A TIMELY OPPORTUNITY FOR A PUBLIC/PRIVATE PARTNERSHIP

by James H. McCall

Director of Project Finance

A well-managed small or privately owned business can readily tap the long-term capital markets to finance its pollution control requirements. A program jointly administered among commercial and investment bankers and the U. S. Small Business Administration enables a business to get long-term, fixed-rate financing to help it meet environmental quality and hazardous waste disposal standards.

Almost 250 businesses funded over $300 million of projects between 1977 and 1982, and thus were able to leverage their equity in much the same way as do major corporations, and without crimping their normal sources of credit or bank financing for their working capital and productive equipment requirements.

This program is SBA's Pollution Control Financing Guarantee which is efficiently operated by a three-member staff in its Office of Special Guarantees at the Washington headquarters. This program has developed excellent credibility and a first class reputation among lenders and participants. It is an excellent example of how the public and private sectors can cooperate.

This program serves an important function in the capital formation process. It reduces a major capital investment threshold for small businesses, helps them to maintain their earning power, and increases their financing leverage capability.

There is a timely opportunity to further expand on this cooperative effort and help reduce the federal government's involvement in this form of credit enhancement.

Small businesses are faced with increased requirements to meet air and water quality standards and to properly manage their industrial wastes. For example, EPA's sewer discharge limitations were upheld by the U. S. Appellate Court, and firms that have been postponing compliance must almost immediately meet strict industrial waste deadlines. As those companies succeed in getting their wastes out of the sewer systems, they must meet requirements for the disposal of hazardous wastes. To do so, they must change their processes, recycle their wastes or neutralize them. All alternatives require new investments.

This is stimulating unprecedented demand for capital financing for these investments. Over 10,000 businesses are estimate to require upwards of $500 million to meet the industrial waste discharge standards. Thousands of other companies will require similar amounts to neutralize, treat or otherwise handle their hazardous industrial wastes. Others are faced with new air pollution requirements, as well.

The demand for this financing can certainly exceed the $150 million of annual guaranteed capacity allocated to the program if, as, and when businesses become aware of the program.

Why then has the program not been active since January 1982?

There are two reasons. First, regulatory enforcement slackened for several years. Hazardous waste problems, the courts, and EPA policy changes have rekindled enforcement. Second, between 1977 and 1982, loans guaranteed by the SBA under this program could be funded with the proceeds of tax-exempt industrial development bonds. Accordingly, small businesses could enjoy the same terms and rates as major companies, with fixed rates of between 5-1/2 and 10-1/2%, which were substantially below their costs for bank financing. For the first time, small businesses had a national program to have their loans funded with marketable securities in the form of tax-exempt bonds.

In February, 1982, the credibility of the program among small businesses was sorely tested. The Office of Management and Budget, unannounced and without any prior indication, forced the SBA to curtail tax-exempt financing as a means for funding these loans, at a time when the SBA had on hand almost $100 million of applications for funding. These applications were returned after a period of months when it was determined that OMB would not relent. The private funding sources which were promoting and marketing the program lost interest.

The businesses which were so affected have had no capital funding alternative for their pollution controls. Major companies, however, still have theirs. This word was disseminated rapidly among the small business community.

Now, enforcement is being focused on these businesses. Owners of small businesses are going to jail when found to be in willful violation of pollution control regulations. The only relief is that EPA has appointed a Small Business Ombudsman to help them avoid becoming violators.

Since OMB's action in 1982, several developments have occurred to help us try to re-establish credibility, rekindle interest, and bring the program up to the speed where it was.

First, we have developed a new form of marketable security as an alternative funding source for tax-exempt bonds.

Pooled Loan Marketing Corporation has been organized to purchase fixed-rate, long-term loans made by banks to induce them to provide this type of financing. The funding for the purchase of the loans will come from the sale by PLMC of pass-through securities similar to those of the Federal Home Loan Mortgage Corporation or the Governmental National Mortgage Association. We expect that they will receive excellent market acceptance and should be readily traded in secondary markets, something the SBA has not yet accomplished with its other programs.

Second, SBA developed new regulations that would simplify the program and make it possible to use these new sources. They were proposed in the Federal Register on November 10,

1983. Several meetings were held nationally with experts and potential leading participants for the program from whom only positive comments were received. The changes in the fee structure and other proposed revisions were necessary to make the PLMC program most viable in the private markets. After objections from OMB, the proposed regulations were not allowed to become effective.

Third, SBA has been mandated to once again guarantee obligations funded with tax-exempt bonds. However, because this mandate was a part of the continuing federal budget resolution, we and other investment bankers are uncertain as to whether this mandate will continue in effect after September 30, 1985. We need clarification and confirmation from Congress that such is its intent.

Fourth, there is an opportunity in the program's enabling legislation that allows for and would encourage the participation in the assumption of risks by the private sector. In other words, we have presented to us the timely opportunity for a participation arrangement between the public and private sectors. To do so, we have asked for the cooperation of SBA with information to undertake such a program.

To encourage private participation, we must review in detail the following questions:

The calculation of the guarantee fee. Our experience is that if there was a commitment to permit this program to run continuously throughout an entire risk assumption cycle (that is, through an entire repayment period) it would function as a successful insurance program. The law of large numbers would prevail to help to diversify the risk, and allow there to be created permanent reserves.

Several years ago, an independent review and analysis of fees for a similar program was conducted, and it was concluded that the rates charged by SBA would be more than adequate. In addition, we have been involved in several other small business assistance programs for which similar fees have been charged. From our experience, the amount being charged by SBA is more than adequate.

Need or Demand. The demand for the program is increasing according to our research, which includes surveys among small businesses which have stimulated a 21% response, and strong interest in the SBA program.

Prior to 1982, many compliance efforts were undertaken in anticipation of strict enforcement. That strict enforcement is now occurring. The appellate court decision upheld that the EPA's standards for industrial waste discharge into sewers confirmed that deadlines for compliance are reasonable regardless of financial hardship for businesses.

In addition, in 1984 Congress eliminated the small hazardous waste generator exemption, thus broadening enforcement of hazardous waste regulations to almost all small businesses nationwide.

These companies are now faced with meeting and satisfying these regulations. EPA has conservatively estimated that there is a demand in excess of $500 million solely for water pollution controls. Our surveys indicate that over $100 million will be needed by just one line of industry among 27 affected by current regulations.

Risk Experience. It should be noted that small businesses suffered disproportionately in the recent severe recession. This program has now gone through a complete business cycle and we should be able to determine whether or not the default rates were fully anticipated. It should also be noted that all claims have been met from the fees paid by the businesses. No federal funds from appropriations or any other sources have thus been used.

We feel that the major risk periods have been identified and that a new fee structure can be developed from the existing data. With this information we can make improvements in the screening, credit analysis and loan processing to make this even more an effective and timely program.

Funding Sources. Small businesses generally rely on secondary sources of credit. Only through this type of program can they get close to the capital markets available to major businesses. This guarantee can be an excellent example of how to bridge small businesses' needs to those markets. It is worthy of a demonstration that can lead to a spin-off of the program, using Ginnie Mae as an example.

We should also like to emphasize that the program has even made infinitesimal contributions to market improvement as over $26 million in fee revenue has been invested in Treasury securities for which private credit needs were not dislocated.

To summarize, the SBA Pollution Control Financing Guarantee program offers an excellent example of how industries, banks and the federal government can work together with the investment banking community to satisfy this growing and important need. There is a sense of urgency that the program must be kept operational to satisfy the forthcoming demands of these businesses. We are receiving daily and increasing numbers of inquiries for this type of financing. There must be an opportunity to continue with the good work that has already been started by the Pollution Control Financing office.

We are committed to continue with this type of financing, and furthermore to exert our best efforts in developing a public/private sector participation arrangement that will be based on the experience of both this program and the growing amount of new credit enhancement devices being used in other areas of public finance. Miller & Schroeder is demonstrating how we can benefit small businesses more directly and attract private capital into this area. To do so, we need a strong long-term commitment that the federal government is willing and able to be a partner to investigate and demonstrate the concepts we have proposed.

* * * * * * * * * *

STATEMENT
OF
JOHN W. McCLURE

on behalf of

THE AMERICAN BANKERS ASSOCIATION

on

PROGRAMS OF THE SMALL BUSINESS ADMINISTRATION

for the

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

MARCH 19, 1985

SUBMITTED FOR THE RECORD

Mr. Chairman and members of the Committee, I am John W. McClure, Executive Vice President of Mercantile Trust Company, N.A., St. Louis, and Chairman of the American Bankers Association's Small Business Credit Committee. The combined assets of our nearly 13,000 member banks represent approximately 95 percent of the industry total. While our members range in size from the smallest to the largest banks, close to 85 percent of them have assets of less than $100 million. I appreciate this opportunity to present our Association's views on the programs of the Small Business Administration (SBA).

Based on the results of a January 1985 survey of small-to mid-sized business owners, the National Federation of Independent Business (NFIB) found that small business optimism about business conditions was up for the second quarter in a row following a downturn in the middle of last year. This optimistic outlook was not uniform in every region of the country, but 37 percent of the respondents felt that business conditions would improve during the first quarter of 1985 and only eight percent thought they would get worse. And even though plans to raise prices were more widespread than they had been for the last 2-1/2 years, more firms were also planning to add workers, build their inventories, and make additional capital outlays.

To help achieve more long-term economic stability (i.e., less inflation, lower interest rates, lower unemployment, more steady long-term real growth, and a stabilization and eventual decline in the ratio of federal debt to GNP), our Association strongly supports action by the Administration and Congress to restrain the growth of federal spending to allow more private savings, investment, and job creation. For this reason, we commend this Committee's thorough review of SBA's programs.

The banking industry has been a major participant in various SBA programs for years. A primary example is the loan guarantee program, which was authorized by section 7(a) of the Small Business Act of 1953. As of September 30, 1984, 9,923 commercial banks (almost 70 percent of the industry total) had at least one guaranteed loan outstanding. Of that total, an estimated 1,627 banks had between 10-24 loans, and 635 banks had 25 or more loans each.

We believe the Administration's proposed elimination of the 7(a) Loan Guarantee Program would have an adverse effect on the ability of our members to provide financial assistance in their communities. In addition to increasing the liquidity and credit strength of our members, the 7(a) Loan Guarantee Program is helpful in promoting economic development, particularly for many smaller community banks. The majority of our members are smaller, independent, community-type organizations that have regulatory constraints on the amount of funds they can lend to any one customer. However, the guaranteed portion of a 7(a) loan is not included in the legal lending limit formula. To illustrate, a bank with a $500,000 legal lending limit could extend up to $1,000,000 of credit to an eligible small business borrower by using the 7(a) Loan Guarantee Program. Furthermore, a bank originating SBA guaranteed loans may sell the guaranteed portion of such loans in an active and recognized secondary market to preserve the funds for additional loans in the community.

The small businesses that would be affected by the Administration's proposed elimination of the 7(a) Loan Guarantee Program could lose their only source of financing or find themselves unable to develop a viable long-term financing package. A 1983 General Accounting Office (GAO) report on the 7(a) Loan Guarantee Program concluded that a reduction in the program's budget "could seriously weaken lenders' ability to respond to small businesses in need of long-term financing." Approximately 82 percent of the lenders surveyed for the report said that the small businesses to which they made loans would not have been financed without the SBA guarantee or would have had different financing terms and conditions. The report found that 74 percent of the SBA loans reported by lenders carried maturities of 6 or more years, while only 15 percent of the loans without SBA guarantees carried similar maturities. Also, around 52 percent of non-SBA small business loans had maturities of less than one year. In addition, the report indicated that approximately 30 to 40 percent of the dollar amount of banks' long-term financing (6 or more years) to small business may carry an SBA guarantee. The report also revealed that the SBA guarantee makes it possible for banks to make larger loans than they would normally provide to small businesses. These results reflect the experiences of our Small Business Credit Committee members with this program.

Moreover, recent information indicates that the 7(a) Loan Guarantee Program has little or no impact on the credit market or the ability of other small businesses to get loans. For example, based upon data received from a representative nationwide sample of over 500,000 NFIB member-firms in April 1984, commercial banks were the major source of the most recent loan for small businesses ranging in size from less than $50,000 to $3,000,000 or more in gross sales, and the major source of the most recent loan in every category relating to a firm's years in business (see the attached tables).

Given the importance of the 7(a) Loan Guarantee Program in long-term financing, the ABA believes that the Administration's proposed elimination of the program would impose hardships on many small businesses and the communities in which they are located. Therefore, our Association believes it would be preferable to restructure or eliminate certain SBA programs and reallocate resources to increase the agency's cost-effectiveness and responsiveness to the needs of the small business community. We think the following recommendations concerning the 7(a) Loan Guarantee Program and some other SBA programs would be helpful in accomplishing those objectives.

7(a) Loan Guarantee Program

Our Association believes that more emphasis should be placed on this program to increase the participation of private sector lenders. This would increase the number of businesses being served with a minimal impact on the federal budget.

This program already transfers much of the administrative and servicing expense to the lending banks. This results in a cost of delivery to the Federal Government which should compare very favorably with the efficiency and cost of other federally-sponsored economic development or public assistance programs. To help fund program costs, we support a guarantee fee of two percent. However, we think any increase above that percentage would retard bank participation in the program.

As recommended in the GAO's report on this program, we think greater emphasis should be placed on reducing 7(a) loan losses. At the same time, we also think that 7(a) loan losses should not be compared to the overall bank loan loss rate. A generalization that 7(a) loan losses are higher than the national average for all bank loan portfolio losses is not an accurate indicator or comparison, partly because 7(a) loans are frequently made to new businesses which historically have a higher default rate than more established firms.

Certified Lenders Program

There are 631 banks currently participating in the Certified Lenders Program. We believe this program, which has served as a model for private sector participation, should be expanded by removing current limitations on the total number of qualified lender participants. To expedite application processing, lenders should be allowed to use their own forms. In addition, allowing lenders to liquidate their failed loans would reduce SBA costs. These administrative changes would increase efficiency and make program participation more attractive. Because satisfactory performance in the Certified Lenders Program is required before a lender can participate in the Preferred Lenders Program, it is especially important that this program be maintained.

Preferred Lenders Program

At the end of this year, an estimated 125 banks should be participating in the Preferred Lenders Program. We think this program has the potential to be the most beneficial to small business owners, private lenders and the SBA. By allowing the lender to assume maximum responsibility for loan approval and servicing, the quality and timeliness of service to the borrower is improved. Therefore, we believe this program should be gradually expanded by annually increasing the number of qualified lenders.

With the expansion of the Certified Lenders and Preferred Lenders Programs, the need for direct on-site personal contact by SBA personnel may be minimized. Consequently, this might be the time to consolidate agency offices. Few states are so big that they could not be efficiently served by one state-wide SBA office. This would permit the elimination and/or consolidation of numerous SBA district and branch offices.

Section 503 Certified Development Company Loan Program

The ABA thinks the section 503 program, which was enacted in 1980, is a valuable financing method for small business because it provides interest rate relief for a portion of the credit. Our Association is opposed to adding this program to the 7(a) Guarantee Loan Program because that would do irreparable damage to the interest rate relief. Another valuable benefit of this program is its proven record of creating jobs at a minimal government cost.

Other Programs

Our Association thinks that direct SBA lending to targeted groups such as minorities or the handicapped should be replaced by private sector lending to these target groups with SBA guarantees. Lender participation could be encouraged by increased levels of guarantees.

We believe the Small Business Investment Company (SBIC) and Minority Enterprise Small Business Investment Company (MESBIC) Programs are cost-effective, but we think alternative financing methods should be explored to make small business investment more attractive.

Our Association also thinks the Advocacy and Procurement Programs should be continued. However, we believe the Management Assistance Program should be eliminated because private and nonfederal sources will continue the programs that deserve sponsorship.

Our Association would be pleased to work with the members and staff of this Committee as you continue your review of these programs.

SMALL BUSINESS FINANCE

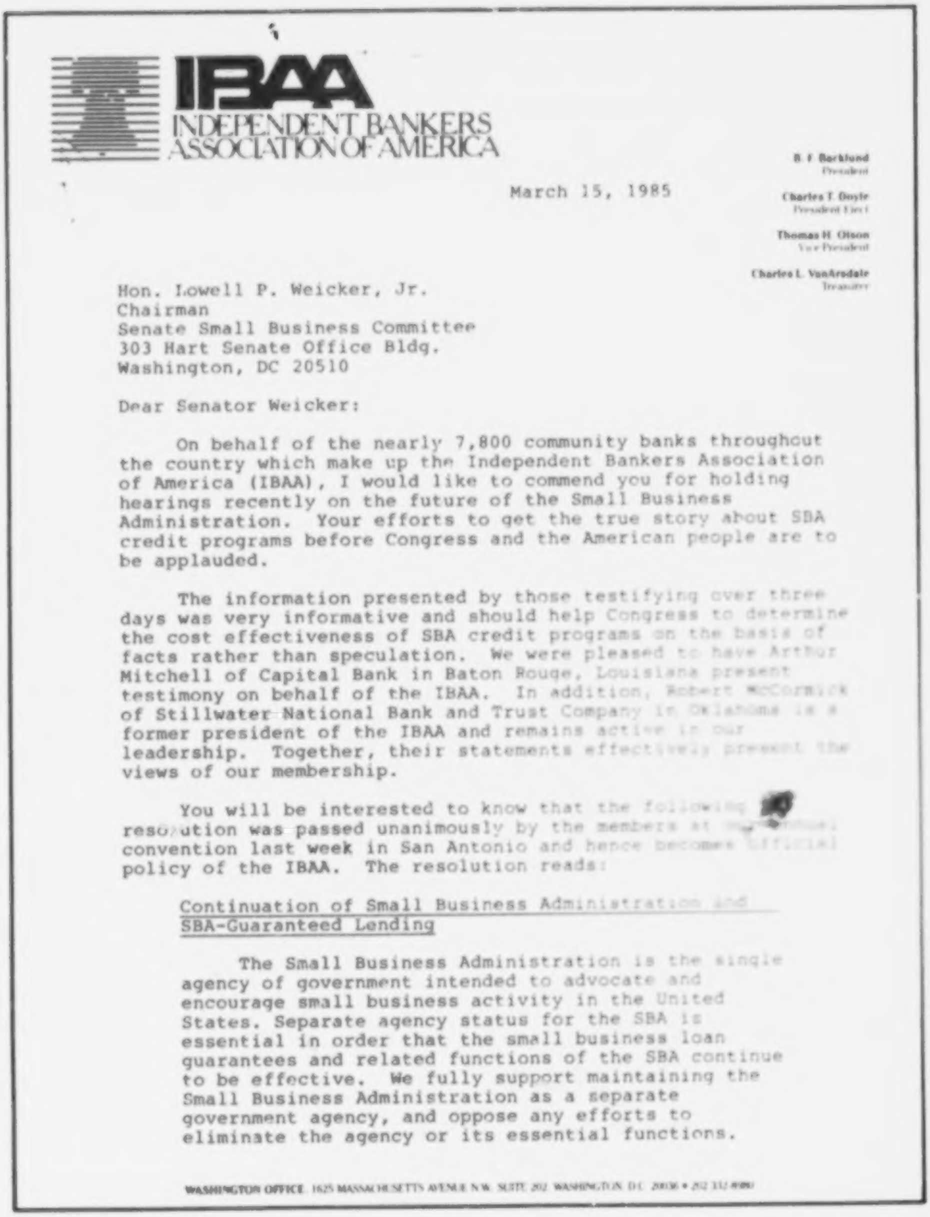
Source of Most Recent Small Business Loan by Gross Sales of Firm

	Gross Sales ($ Thousands)								
Source of Loan	Under 50 %	50-199 %	200-499 %	500-799 %	800-1,499 %	1,500-2,999 %	3,000 or more %	No Answer %	Total %
Bank (full service)	73	76	78	82	84	92	85	86	80
Bank Loan Office (no deposits taken)	2	1	1	2	4	1	4	4	2
Private Person	5	6	6	3	2	0	2	0	4
Finance Company	4	3	2	1	2	1	2	0	2
Savings and Loan	3	3	2	1	2	1	0	0	2
Credit Union	3	2	1	2	0	0	0	4	1
Government	0	1	1	4	1	2	0	0	1
Insurance Company	2	1	2	1	0	0	2	0	1
Other	5	4	5	3	2	1	2	7	4
No Answer	2	3	2	2	2	3	3	0	2
	100	100	100	100	100	100	100	100	100
Number of Loans	116	387	343	136	167	112	123	28	1,412

Source of Most Recent Small Business Loan by a Firm's Years in Business

	Years in Business								
Source of Loan	1-2 %	3-4 %	5-6 %	7-10 %	11-15 %	16-20 %	21 & Over %	No Answer %	Total %
Bank (full service)	82	75	79	80	87	84	77	73	80
Bank Loan Office (no deposits taken)	1	1	2	2	1	1	3	8	2
Private Person	7	9	5	4	5	3	2	8	4
Finance Company	4	3	1	4	1	1	3	0	2
Savings and Loan	0	3	3	3	1	3	1	8	2
All Other Lenders	4	8	7	5	2	6	11	0	8
No Answer	2	1	3	2	3	2	3	4	2
	100	100	100	100	100	100	100	100	100
Number of Loans	113	120	125	250	202	145	431	26	1,412

Source: Credit, Banks, and Small Business, a National Federation of Independent Business survey, April 1984.



IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

B. F. Backlund
President

Charles T. Doyle
President-Elect

Thomas H. Olson
Vice President

Charles L. VanArsdale
Treasurer

March 15, 1985

Hon. Lowell P. Weicker, Jr.
Chairman
Senate Small Business Committee
303 Hart Senate Office Bldg.
Washington, DC 20510

Dear Senator Weicker:

On behalf of the nearly 7,800 community banks throughout the country which make up the Independent Bankers Association of America (IBAA), I would like to commend you for holding hearings recently on the future of the Small Business Administration. Your efforts to get the true story about SBA credit programs before Congress and the American people are to be applauded.

The information presented by those testifying over three days was very informative and should help Congress to determine the cost effectiveness of SBA credit programs on the basis of facts rather than speculation. We were pleased to have Arthur Mitchell of Capital Bank in Baton Rouge, Louisiana present testimony on behalf of the IBAA. In addition, Robert McCormick of Stillwater National Bank and Trust Company in Oklahoma is a former president of the IBAA and remains active in our leadership. Together, their statements effectively present the views of our membership.

You will be interested to know that the following resolution was passed unanimously by the members at our annual convention last week in San Antonio and hence becomes official policy of the IBAA. The resolution reads:

> Continuation of Small Business Administration and SBA-Guaranteed Lending
>
> The Small Business Administration is the single agency of government intended to advocate and encourage small business activity in the United States. Separate agency status for the SBA is essential in order that the small business loan guarantees and related functions of the SBA continue to be effective. We fully support maintaining the Small Business Administration as a separate government agency, and oppose any efforts to eliminate the agency or its essential functions.

WASHINGTON OFFICE 1625 MASSACHUSETTS AVENUE N.W. SUITE 202 WASHINGTON, D.C. 20036 • 202 332-8980

> IBAA especially urges the maintenance of a strong SBA-guaranteed lending program. SBA guarantees are useful in channeling funds to small businesses which otherwise would have difficulty competing for adequate credit. The sale of guaranteed loans in the secondary market enables a flow of funds into fund-deficient areas to finance local enterprises, and can also enable local institutions to extend longer term credit to smaller businesses.

The IBAA elaborated on the importance of the SBA and loan guarantees in helping to meet small business credit needs in a statement submitted on February 6 to the Senate Small Business Committee. It is worth reiterating our viewpoint here:

> The Importance of the SBA & SBA Programs
>
> Deregulation of the interest rates banks can pay on deposits has already had an impact on the financing available to small businesses. Real interest rates are higher and more volatile than before and the greater uncertainty in the cost of funds has all but eliminated the ability of banks to make long-term, fixed rate commercial loans. In such an environment the SBA loan guarantee program has played a critical role in making this important form of financing available to small firms. A recent GAO report indicated that nearly 40% of long-term, fixed rate loans to small businesses were made in conjunction with an SBA guarantee. Only last year, the President signed into law a bill which authorized the pooling of SBA guaranteed loans for resale on the secondary market, a program designed to increase the availability of such loans. IBAA supported this legislation because we believe that an expanded secondary market will help banks to make more long-term loans.
>
> We are therefore greatly concerned about the Administration's proposal to eliminate funding for SBA in the 1986 budget. The IBAA strongly supports continued existence of the SBA and its loan guarantee programs as part of an independent agency. The guarantee programs have been improved tremendously in recent years. The Certified and Preferred Lenders Programs have removed the key credit decision process from the SBA and placed it with private lenders, which have extensive credit experience and know their business communities intimately. It would be a tremendous disservice to the small business community to discontinue or curtail the guaranteed loan programs under SBA. The IBAA pledges to help

this Committee in its efforts to keep the SBA alive and in the business of guaranteeing loans.

Having participated in the Committee's hearings, there are several points that we would like to make in response to statements made by others.

In particular, OMB Director David Stockman's repeated claim throughout his presentation that the loans made under an SBA guarantee are subsidized does not present an accurate picture of the lending market. As all participating bankers and borrowers will readily afirm, loans made with an SBA guarantee are at market rates (typically prime plus two or three points). They are not below the rates paid on other loans made to other small businesses.

Although it is possible to argue that guaranteed loans are subsidized in the sense that borrowers would have to pay above market rate for long-term (and certainly for fixed rate) loans, because there is no long-term lending market, no one can say what the rate for an unguaranteed loan would be except to say that it would be higher than the amount currently paid for a guaranteed loan. Indeed, commercial lending officers testify that small businesses are willing to pay higher rates for long-term, fixed rate loans, but they are generally unobtainable. In any case, Mr. Stockman's characterization of guaranteed loans as subsidized is taken pejoratively by the public and as such is misleading.

What Mr. Stockman did not show anywhere in his presentation is that either (a) there is sufficient long-term and fixed rate credit available to small businesses nationwide or (b) small businesses as a group do not need such loans to finance expansion, new plant and equipment. It seems that Congress should not consider abolishing the SBA until it is convinced that either (a) or (b) is true. To the best of our knowledge, every leading expert in small business finance would argue that long-term credit is essential to growing small firms and that the supply is woefully inadequate. It is precisely in this area that the SBA's presence is so significant.

In its testimony, the National Federation of Independent Business (NFIB) suggested that the user fee concept be applied more aggressively to SBA loan guarantees. The current fee charged by the SBA for its guarantee is 1% and NFIB proposed raising it to as much as 5%. In our view, such an increase is unworkable and would severely hamper if not destroy the market for guaranteed loans. Banks would not find it profitable to make loans on that basis unless they could pass most of the cost along to the borrower. We doubt whether small firms could bear such a jump in cost. Other than the NFIB, no other small business groups have supported such an increase.

It is possible that the guarantee is underpriced at 1%. Because there is no existing market for long-term loans, especially at fixed rates, it is impossible to say what the market-determined price would be. Conversations with several lenders indicate that it is probably in the range of 1 to 2%. Ideally, the value of a guarantee could best be determined by a market process such as allowing the borrower to bid for a guarantee. But absent such a mechanism, the best way to raise the guarantee fee would be to do so gradually while observing the effect on the market (e.g., raise it from 1 to 2% for a period of time, then raise it again only if it appears that borrowers and lenders have not dropped out of the market, and continue incrementally until a true market value is approached). To raise the fee to 5% all at once seems both unjustifiable and unwise.

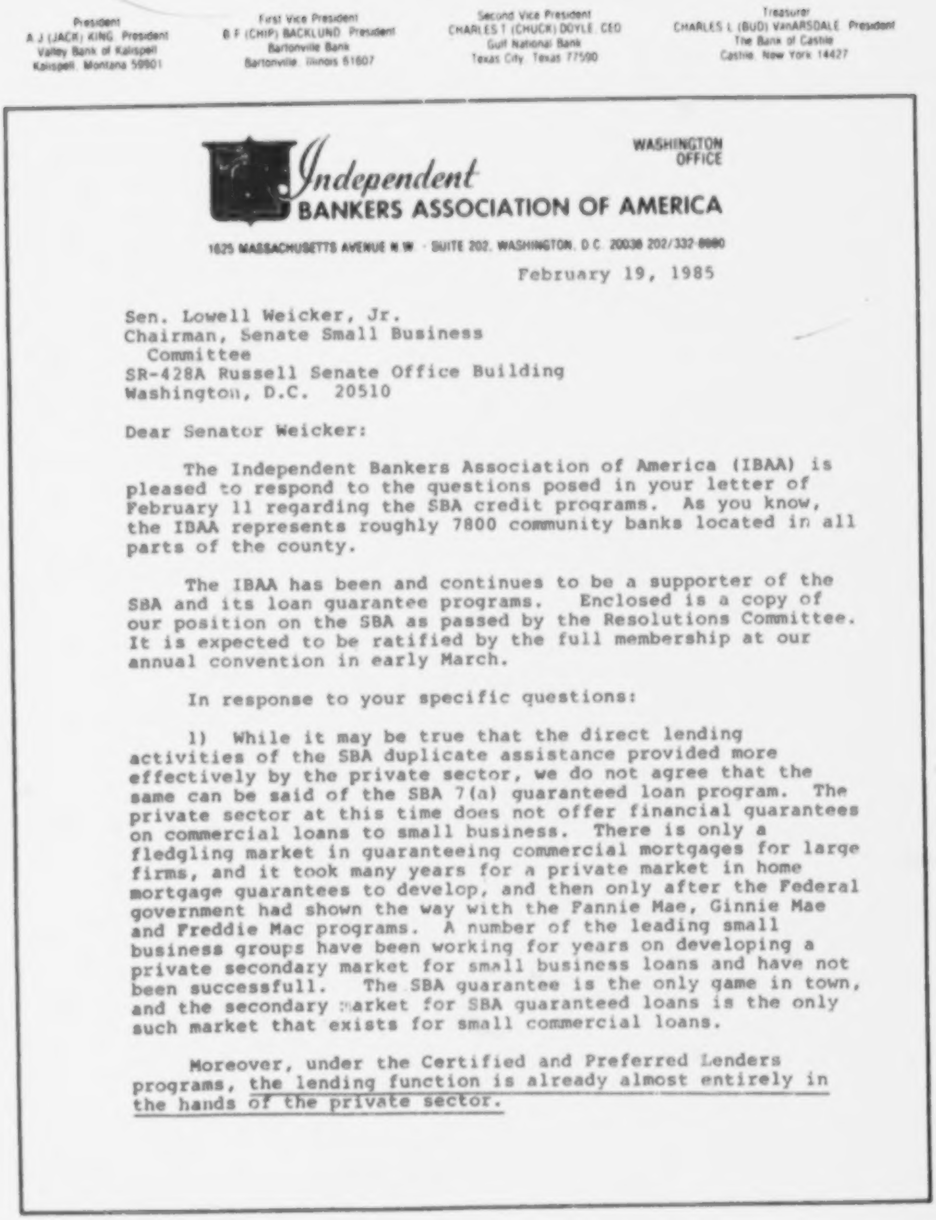
Another proposal that has surfaced recently in connection with the battle to save the SBA would be to reduce the government guarantee on a loan from 90% to some lower amount (75% is most commonly mentioned). In our view, it is premature to move exclusively to a 75% guarantee at this time. As you know, the SBA has been moving steadily in this direction with its pilot Preferred Lenders Program, which recently has gone nationwide. Most if not all Certified Lenders (which make 90% guaranteed loans) will become Preferred Lenders (which receive a 75% guarantee on loans) through a gradual, orderly process over a period of time. This is appropriate because Certified Lenders have sufficient experience in making a large volume of SBA loans to make the transition to reduced guarantees fairly easily.

Those banks that make guaranteed loans but not in sufficient amounts to qualify as a Certified Lender are not likely to be ready to make loans guaranteed at 75% on a profitable basis. And it is our understanding that the numbers would not work for nonbank SBA lenders to profitably make loans with less than a 90% guarantee. We support the SBA's current effort to move gradually toward lending with a lower guarantee. That process ought to continue. But it has taken too many years to develop the market for guaranteed loans to its present stage to justify making such an abrupt change now.

We appreciate this opportunity to present the IBAA's views on continued funding of the SBA and its guaranteed loan program. I respectfully request that these comments be submitted for the record as an addition to our earlier testimony.

Sincerely,

Kenneth A. Guenther
Executive Vice President



President
A J (JACK) KING, President
Valley Bank of Kalispell
Kalispell, Montana 59901

First Vice President
B F (CHIP) BACKLUND, President
Bartonville Bank
Bartonville, Illinois 61607

Second Vice President
CHARLES T (CHUCK) DOYLE, CEO
Gulf National Bank
Texas City, Texas 77590

Treasurer
CHARLES L (BUD) VanARSDALE, President
The Bank of Castile
Castile, New York 14427

Independent
BANKERS ASSOCIATION OF AMERICA

WASHINGTON
OFFICE

1625 MASSACHUSETTS AVENUE N.W. · SUITE 202, WASHINGTON, D.C. 20036 202/332-8980

February 19, 1985

Sen. Lowell Weicker, Jr.
Chairman, Senate Small Business
  Committee
SR-428A Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Weicker:

The Independent Bankers Association of America (IBAA) is pleased to respond to the questions posed in your letter of February 11 regarding the SBA credit programs. As you know, the IBAA represents roughly 7800 community banks located in all parts of the county.

The IBAA has been and continues to be a supporter of the SBA and its loan guarantee programs. Enclosed is a copy of our position on the SBA as passed by the Resolutions Committee. It is expected to be ratified by the full membership at our annual convention in early March.

In response to your specific questions:

1) While it may be true that the direct lending activities of the SBA duplicate assistance provided more effectively by the private sector, we do not agree that the same can be said of the SBA 7(a) guaranteed loan program. The private sector at this time does not offer financial guarantees on commercial loans to small business. There is only a fledgling market in guaranteeing commercial mortgages for large firms, and it took many years for a private market in home mortgage guarantees to develop, and then only after the Federal government had shown the way with the Fannie Mae, Ginnie Mae and Freddie Mac programs. A number of the leading small business groups have been working for years on developing a private secondary market for small business loans and have not been successfull. The SBA guarantee is the only game in town, and the secondary market for SBA guaranteed loans is the only such market that exists for small commercial loans.

Moreover, under the Certified and Preferred Lenders programs, the lending function is already almost entirely in the hands of the private sector.

2) With the lifting of interest rate ceilings banks could pay on deposit accounts in 1980, the advent of double-digit inflation in 1979-81, and the accompanying volatility of interest rates, banks are required to match their assets with increasingly short-term, volatile liabilities and are reluctant to make a loan longer than two years. Fixed rate loans are similarly scarce. Where a loan of 5 to 8 years used to be considered longer term, loans of more than 18 months to 3 years are now considered "long term". Yet a business seeking to expand or purchase new plant and equipment requires long term credit to do so.

Large corporations have access to long term credit through the bond and commercial paper markets. But small firms rely upon commercial banks for nearly 80% of their credit needs. As a result, long term credit has all but disappeared for small firms.

The SBA guarantee in recent years has been used by banks in response to this financing gap. That is, loans that the bank might only be able to make for a year or two at a variable rate can be extended in term to 5 to 8 years with SBA's guaranteed, in many instances at a fixed rate on the 90% guarantee portion. If the guarantee program is eliminated, it will again become practically impossible for banks to make long term financing available to small firms.

3) About 125 of our member banks are in the Certified Lender Program and several more are Preferred Lenders. These are banks that are extremely active in making SBA loans, which make up a significant portion of their total loan portfolio. A much greater number participates in SBA lending on a smaller scale, either by making a few SBA loans a year or by purchasing loans on the secondary market. The purchase of loans by a bank with slack loan demand in one area provides banks in areas of strong loan demand with the ability to meet that demand and better service the small business community at large.

4) In some cases financing would not be available without the SBA guarantee. But as noted above, in most cases financing might well be provided to a business without an SBA garantee but not the same type of financing. That is, a small business that really needs a long term loan to expand its facilities might only be able to get a short-term loan at a variable rate from the bank, which is not an attractive or appropriate method of financing. It is the SBA guarantee that makes it possible for a bank to lend long term and accurately match the financing with the economic life of the assets financed. And in most cases, the guaranteed loan is made at a fixed rate, which is clearly preferable for the borrower and allows the business to plan its working capital needs much more effectively.

5) The great advantage of the SBA loan guarantee is that it allows the lender to sell a loan into the secondary market that has developed for such loans. Responsibility for the

remaining 10 or 25% of a guaranteed loan remains with the lender and the lender continues to service the loan as if it were still in the possession of the lender. But because the loan has been sold, a bank which may be approaching its lending limit can then make another loan, allowing a recycling of the bank's available loan money. The result is more loans get made to deserving small firms.

The other advantage of guarantees issued under the Certified or Preferred Lender programs is that the turn around time on loan decisions is very quick and the responsibility for a decision lies with the banker who is expert in making credit decisions rather than a government bureaucrat who is not.

6) According to the best information available, the SBA loan guarantee program has no significant impact on the availability of credit to small businesses not using the program. Surveys done by the National Federation of Independent Business indicate that there is no shortage of credit for operating small businesses. In most cases, availability of credit is not a problem. To reiterate, the SBA guarantee is operating in a way that extends the term of the loan, and perhaps fixes the rate, for customers that otherwise would only be able to get short-term credit. It does not displace other creditworthy borrowers.

7) In discussions with five of our most active SBA lenders, it appears that they sell most of their guaranteed loans in the secondary market and a few sell every guaranteed loan they make. It depends on the bank and the loan demand they face. The heavier the demand for loans, the more are sold so that the bank doesn't bump up against its lending limit. This process also benefits business borrowers because the bank can recycle the funds from a loan sale into new loans and continue to make loans rather than stop when it hits its lending limit.

We appreciate the opportunity to respond to your questions and stand ready to assist you in any way that we can to assure that an accurate picture of SBA lending is presented to the Congress.

Sincerely,

K. Guenther

Kenneth Guenther

Executive Director

(29) CONTINUATION OF SMALL BUSINESS ADMINISTRATION AND SBA-GUARANTEED LENDING

The Small Business Administration is the single agency of government intended to advocate and encourage small business activity in the United States. Separate agency status for the SBA is essential in order that the small business loan guarantees and related functions of the SBA continue to be effective. We fully support maintaining the Small Business Administration as a separate government agency, and oppose any efforts to eliminate the agency or its essential functions.

IBAA especially urges the maintenance of a strong SBA-guaranteed lending program. SBA guarantees are useful in channeling funds to small businesses which otherwise would have difficulty competing for adequate credit. The sale of guaranteed loans in the secondary market enables a flow of funds into fund-deficient areas to finance local enterprises, and can also enable local institutions to extend longer term credit to smaller businesses.

NORRIS CITY STATE BANK

"SOUND PROGRESSIVE GROWING"

N C
S B
MEMBER FDIC

TELEPHONE [illegible]
NORRIS CITY, ILLINOIS 62869

February 13, 1985

Mr. Donald Regan
Senior Staff Advisor
The White House
Washington, D.C.

Re: The Small Business Administration

Dear Mr. Regan:

Last week I had occasion to call the Springfield office of the Small Business Administration. I was snocked to learn that SBA is to be terminated. I promptly called the offices of Senator Alan Dixon, Senator Paul Simon and Congressman Kenneth Gray to ask them to please make every effort to keep the SBA in business.

You, Mr. Regan, with your background in the large business world are perhaps unaware or insensitive to the needs of the small businesses of America. Admittedly, SBA has had far too many bad loans, however if you will look into the background of those loans on a broad basis, you will discover that as a result of Congressional pressure of five, six, eight years ago, on SBA to make social program related loans that were really not credit worthy to begin with and therefore the loan losses were very large. Congress itself is to blame for that result and not the SBA. If all SBA loans were made on a proper credit worthy basis, with the degree of risk evaluated carefully, those loan losses would be sustainable. If the SBA program has flaws as now constituted, then lets correct those flaws but not destroy a very important and necessary organization that contributes much to the small business firms across this country.

The SBA is the primary source of risk money for the small business firms across this country. If you shut out that source of funding, then you destroy the opportunities for creation of jobs in the small business world.

I know my one small voice crying in the wilderness will probably have no effect on you or Congress, but it is a grassroots feedback to you and those in Washington. I run a small $25 million country bank and I see the needs and the problems of small businesses.

I recognize the drive behind this action to help to balance the federal budget. I totally agree with balancing that budget and don't take four years to do it. It seems reasonable to me that when America sends Congress 800 billion dollars to run the country, it certainly ought to be a good enough manager to make those funds do the job and not have to borrow another 150 or 200 billion dollars. This is ridiculous and if it was in the private sector, managers that were coming up with that result would be promptly terminated.

I am sending copies of this letter to Senator Alan Dixon, Senator Paul Simon and Congressman Ken Gray from Illinois to hopefully encourage their support of modifying or correcting SBA if it has shortcomings but keeping it in business for the good of small businesses across America. Also, I am sending a copy to Vice-President George Bush, because from every indication that I see of him, he is a person of sound financial judgement.

In closing, I beg of you to do all that you can to keep the Small Business Administration alive and healthy.

Yours sincerely,

Bruce Burnett

Bruce Burnett
Chairman

BB/pb

CC: Vice President George Bush
Senator Alan Dixon
Senator Paul Simon
Congressman Ken Gray
Stephen J. Veerdier, IBAA, Washington
Don Brookhart, SBA, Springfield, IL

FIRST NATIONAL
BANK of Clinton

February 14, 1985

Additional copies to: John Danforth
Ike Skelton

The Honorable Thomas Eagleton
107 Dirksen Building
Washington, D.C. 20510

Re: Reagan Administration Elimination of SBA in 1986 Budget Proposal

Dear Mr. Eagleton:

I would like to call your attention to the above referenced matter. The Small Business Administration, as the only non-regulatory governmental agency, provides perhaps the best application of tax dollars to stimulate economic growth of any federal entity.

In our small community bank alone, in a town of 8,500, our portfolio of SBA loans has helped 30 businesses finance their operations; employ over 150 people; and generate annual sales in excess of $10,000,000. Considering the number of times each dollar "rolls-over" in our community; the impact is substantial. Also of value to our area is that several of these businesses are wholesale, tourist, and regional related businesses, allowing an influx of "new money" into our economy.

Our financial institution supports budget programs to eliminate the federal deficit. Within this philosophy, however, programs must be evaluated on their merit, significance to local economies, and generation of tax dollars. I recommend the eliminiation of non-effective SBA programs such as direct lending and non-physical disaster loans.

I can understand that perhaps from a big city perspective, such as Mr. David Stockman's, that SBA programs assist undeserving businesses and the number may be small. However, let me assure you and your constituents, that the impact on our community is significant. I have enclosed for your review a resolution prepared by the Independent Bankers Association of America and encourage your adherence to this position.

Sincerely,

Ron Arthur
Vice President

P. O. BOX 606 CLINTON, MISSOURI 64735 MAIN BANK (816) 885-3365 BRANCH (816) 885-6166

Bankers' Bank
OF WISCONSIN

February 14, 1985

COPY

The Honorable Robert Kasten
United States Senate
Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Kasten:

In this nation's love affair with big business and large scale success stories, it is often easy to overlook the thousands of small business contributors to our economy. The prospect of losing the Small Business Administration which has been a bootstrap for many small businesses is distressing and frightening.

As a banker working with small business, I have used the Small Business Administration on numerous occasions. Because of the S.B.A. I have seen businesses which could never have begun, flourish, add employment, provide an economic benefit and pay taxes. An agency such as the S.B.A. has provided encourgement and advice to small business and, sometimes, imposed the outside discipline needed to make a venturist a business person.

Small banks in particular benefit from the S.B.A. Small banks cannot afford to take the venture capital risk to promote new business creation--the S.B.A. has provided a means. In this day of massive government budgets, deficits, give away programs and bureaucratic excess, a small budget item that is as useful as the S.B.A. should be allowed to continue and perhaps expand.

I regret that the statistics are not available to me, but I think it would be a safe wager that the taxes paid by businesses, their employees, suppliers, and creditors pay for the S.B.A. costs over and over.

This nation's greatness was built on the individual efforts working toward a combined benefit. Let us not become so large, that we lose sight of our base roots. Please support efforts to maintain the Small Business Administration.

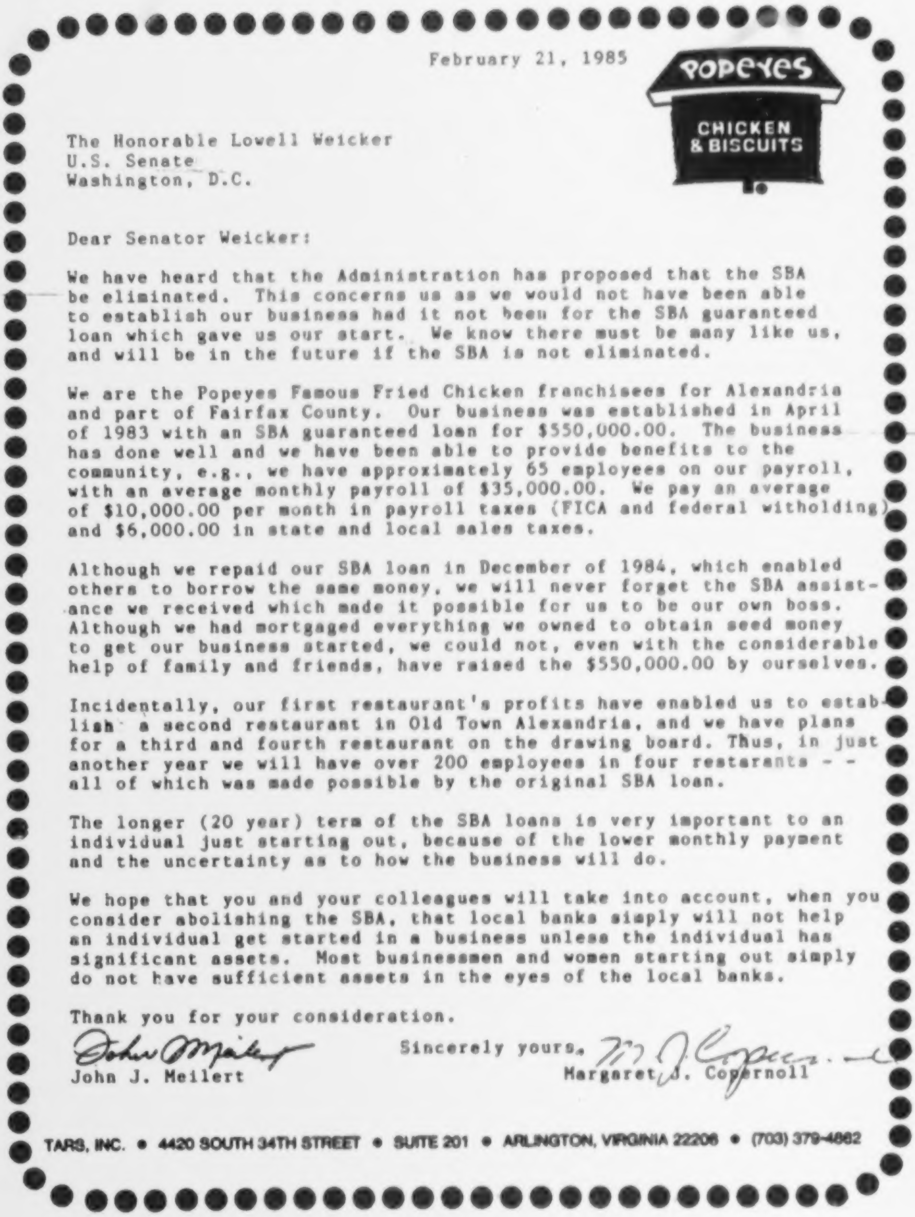
Sincerely,

Helge S. Christensen
President

HSC/as

Ken - for your info.
Same letter to Proxmire and Rep. Kastenmeier.

30 West Mifflin Box 2238 Madison, WI 53701 608-251-2001



February 21, 1985

POPEYES
CHICKEN & BISCUITS

The Honorable Lowell Weicker
U.S. Senate
Washington, D.C.

Dear Senator Weicker:

We have heard that the Administration has proposed that the SBA be eliminated. This concerns us as we would not have been able to establish our business had it not been for the SBA guaranteed loan which gave us our start. We know there must be many like us, and will be in the future if the SBA is not eliminated.

We are the Popeyes Famous Fried Chicken franchisees for Alexandria and part of Fairfax County. Our business was established in April of 1983 with an SBA guaranteed loan for $550,000.00. The business has done well and we have been able to provide benefits to the community, e.g., we have approximately 65 employees on our payroll, with an average monthly payroll of $35,000.00. We pay an average of $10,000.00 per month in payroll taxes (FICA and federal witholding) and $6,000.00 in state and local sales taxes.

Although we repaid our SBA loan in December of 1984, which enabled others to borrow the same money, we will never forget the SBA assistance we received which made it possible for us to be our own boss. Although we had mortgaged everything we owned to obtain seed money to get our business started, we could not, even with the considerable help of family and friends, have raised the $550,000.00 by ourselves.

Incidentally, our first restaurant's profits have enabled us to establish a second restaurant in Old Town Alexandria, and we have plans for a third and fourth restaurant on the drawing board. Thus, in just another year we will have over 200 employees in four restarants - - all of which was made possible by the original SBA loan.

The longer (20 year) term of the SBA loans is very important to an individual just starting out, because of the lower monthly payment and the uncertainty as to how the business will do.

We hope that you and your colleagues will take into account, when you consider abolishing the SBA, that local banks simply will not help an individual get started in a business unless the individual has significant assets. Most businessmen and women starting out simply do not have sufficient assets in the eyes of the local banks.

Thank you for your consideration.

Sincerely yours,

John Meilert
John J. Meilert

Margaret J. Copernoll

TARS, INC. • 4420 SOUTH 34TH STREET • SUITE 201 • ARLINGTON, VIRGINIA 22206 • (703) 379-4862

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15 February 1985

Honorable Lowell E. Weicker
Chairman, Senate Small Business Committee
Washington, DC

Dear Mr. Weicker:

I recently formed a small business--Arrow Computer Supply, Inc.--with the assistance of an SBA guaranteed loan. The business involves the distribution of computer supplies to commercial accounts in Northern California.

I originally sought long-term financing through traditional banking channels but was dismayed to find that even with excellent collateral property my loan request was denied. Numerous banks perceived my acquisition of assets and a customer base from an existing business to be too risky for them. Finally, I discovered First Capital California Business and Industrial Development Corporation who was instrumental in securing an SBA guaranteed loan for me.

The loan has enabled me to adequately fund my new company and in our first year of operation, sales have exceeded $750,000. The Company now employs six (6) individuals and yielded a taxable profit for the year ended 1984.

Needless to say, I am excited about the future propects of my business. None of this would have been possible without the SBA guaranteed loan.

I firmly believe that small businesses contribute greatly to the American economy and that the SBA guarantee loan program should be continued.

Very truly yours,

Anthony G. Walker
President

20 B Pimentel Court, Suite 10 • Novato, California 94947
415-382-0190

SINGER
PRINTING COMPANY

February 15, 1985

Honorable Lowell E. Weicker
Chairman, Senate Small Business Committee
Washington, DC

Dear Chairman Weicker;

We are a small printing firm in Sonoma County, California. Before receiving our Small Business Administration loan, the hope of ever growing and purchasing modern equipment was nil.

Although we made a sizable profit in the first three years since beginning in 1981, local banks and leasing companies turned down our requests for money time after time. They were very aplolgetic, even complimentary as to the future potential and quality of our product. However, they did not want to be the first to take the risk. My feeling was that if I already had the money, they would lend me the money. One conventional lender even advised me to come back to him in two years and he'd then give me all the money I could need. But how was I to get to that point two years down the road.

This is where the SBA plays a crucial role in the development of the American Dream. I started my company out of a garage in 1977, moved to Sonoma County in 1981 and the SBA loan I recently received will generate sales for 1985 of one half a million dollars. I have been able to purchase a 2 color Heidelberg Press, camera equipment, a darkroom and cutter. The new equipment has allowed me to be more competitive in my pricing and has greatly improved the quality of our printed product.

In just three short months, our business is beginning to double and we have needed to hire two more people to help with our work load. And this is just the beginning!!

Who do I have to thank for this? The banks, the leasing companies? No! It is First Capital Corporation, a guaranteed SBA lender, and the SBA for their confidence and assistance. I am endebted to both of them - they have made the crucial difference.

Please do whatever is in your power to continue to help young entrepreneurs in the future!!

Sincerely,

Barry T. Singer

1364 N. McDowell Blvd. Petaluma, CA 94952 (707) 778-1774

Tools-r-us
10251 So. De Anza Blvd., Cupertino, CA 95014 (408) 725-8300

Febuary 18, 1985

Honorable Lowell E. Weiker
Chairman, Senate Small Business Committee
Washington, DC

Dear Mr. Weicker:

Tools-R-Us began in 1980 with a Small Business Administration guaranteed loan. Our first year as a retailer of tools grossed $60,000. We certainly could never have begun our business without the SBA.

In 1982 First Capital Corporation helped us arrange a second SBA guaranteed loan. Sales in 1984 were over $2,700,000. We employ over twenty people.

No bank has been willing to help make our concept become a reality. Someday we hope to be a nationwide organization. Only with the help of the Small Business Administration could we even dream of this goal.

Sincerely,

Donald G Lee

Donald Lee

imt

OLD
DOMINION
SYSTEMS, INC.
Serving Government and Industry

February 20, 1985

Senator Lowell P. Weicker, Jr.
Senate Committee on Small Business
% Mr. Bailey Bannard
% Dickstein, Shapiro & Morin
2101 L Street, N.W.
Washington, D.C. 20037

Dear Senator Weicker:

I am writing to you at this time to express my concern with respect to the possible dissolution of the United States Small Business Administration. It is doubtful that our company would be in business today without the support we had received from SBA during our early formative years. During the approximate time frame from 1971 to 1976, Old Dominion Systems, Incorporated, was able to obtain bank financing from the Northern Virginia Bank by borrowing against U. S. Government receivables. Ninety percent (90%) of the loans we received, collateralized by our receivables, were guaranteed by SBA.

Our latest fiscal year, which ended on October 31, 1984, shows that we had revenues of about $13,600,000 on which federal and state taxes in excess of $400,000 were paid. At the present time we have some 200 employees residing in the District of Columbia and the surrounding counties in Virginia and Maryland.

I urge you to allow this agency to survive and continue its good work.

Very truly yours,

OLD DOMINION SYSTEMS, INC.

J. G. Hartwell
President

JGH:llc

4 PROFESSIONAL DRIVE • SUITE 119 • GAITHERSBURG, MARYLAND 20760 • TELEPHONE (301) 948-5200

COMPUTER DESIGN SERVICES INC.

9487 SILVER KING COURT • FAIRFAX, VIRGINIA 22031
TELEPHONE (703) 385-3707

February 21, 1985

Senator Lowell P. Weicher, Jr.
Senate Committee on SBA
Washington, D.C.

Dear Sir;

I am writing this letter in order to offer my opinion on the benefits of the SBA. We have been in business for four years, with my partner and I providing capitalization coming from personal loans. Our initial capital equipment purchase was financed by the manufacturer at 24% interest rate. Two more purchases of capital equipment were also financed by the manufacturer at 24%. The amount of these loans was approximately $170,000.

After two years of operation, we approached several banks in order to acquire refinancing to reduce our interest payment burden. For the most part they were unreceptive, although our records showed an excellent credit record, sales growth, and backlog. Finally, a small bank in Fairfax agreed to back us with SBA approval. We were approved and received a loan for $160,000. This loan reduced our monthly outlay of cash from $4,800 to $2,800 and gave us much-needed room to expand in a growing marketplace.

We have recently purchased an additional computer system, and have further expanded our services which opened new customer fields.

I would hesitate to say that we would not be in business without SBA backing. However, the $2,000/month that the first loan allowed us, did place us in a position to expand into the new area and hire new people to help staff the operation.

Sincerely,

Richard J Rosica

Richard J. Rosica
President

RJR/kdep

6291 WAREHOUSE WAY SACRAMENTO CA 95826
916 381 3291

February 15, 1985

TO WHOM IT MAY CONCERN,

ALSTON INDUSTRIES, INC. is a small manufacturer in an extremely vertical market. Because of the nature of the automotive after-market, tremendous amounts of capital must be spent both on advertising and promotion (in excess of 14%) continually. In addition over 5% must be continually plunged into ongoing R & D. ALSTON INDUSTRIES, INC. has a commitment to remain on the leading edge of technology in the field of race car development and it is at best a very expensive propositon.

ALSTON INDUSTRIES, INC. has been in business for over eight years and we currently employ 30 people. Our current yearly sales are in excess of two million dollars and with the release of our new disc brake technology the volume should double within a short time.

The new brake technology we have developed and have in the PATENT PROCESS will allow the traditional OE manufacturers to build brakes calipers that will save over 25% of the weight over the current calipers in use. This will translate into greater fuel efficiencies.

Without the assistance of the SBA loan funds it would be virtually impossible to bring about the technological advances fast enough (if at all) to be of any significant use to the AMERICAN CONSUMER.

It is with this concern in regards to the SBA program that I am communicating our feelings in regards to the proposed elimination of the SBA.

Regards,

Thomas A. Alston
PRESIDENT
ALSTON INDUSTRIES, INC.

TA/at

ACEC file #312.

American Consulting Engineers Council
1015 Fifteenth Street, N.W., Washington, D.C. 20005
202-347-7474
Telex #97445 AMCONENGRC WSH

March 25, 1985

The Honorable Lowell P. Weicker, Jr.
Chairman, Committee on Small Business
United States Senate
428A Russell Senate Office Building
Washington, D.C. 20510

Dear Chairman:

The American Consulting Engineers Council (ACEC) is pleased to provide its comments and recommendations regarding the reauthorization of the Small Business Administration's budget and programs. We respectfully request that these comments be included as part of the Committee's hearing record.

ACEC is a national federation of 4,200 engineering firms in private practice representing more than 130,000 employees. These firms range in size from sole proprietorships to multi-branch corporations, and span all engineering disciplines. However, a very large majority are small business; ninety-seven percent of ACEC's members fall within the Small Business Administration's size standard for our profession.

ACEC welcomes this Committee's in-depth review of the effectiveness of current Small Business Administration programs and policies. Current federal fiscal constraints will require a careful assessment of costs associated with programs and policies which supposedly benefit 98% of the nation's businesses. ACEC believes that many of these programs must be fine-tuned to more responsively, effectively, and efficiently assist growth-oriented, emerging small businesses to compete.

We believe that the SBA has lost sight of the philosophy of the Small Business Act (P.L. 95-507) that "....Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgement be assured." Unfortunately, programs originally initiated to implement this philosophy have become mired in the process itself.

We believe that implementation of the Competition in Contracting Act (P.L. 98-369), the Defense Procurement Reform Act (P.L. 98-225) and the Small Business Procurement and Competition Enhancement Act (P.L. 98-577) enacted last year will greatly

President CLIFFORD E. EVANSON, Glencoe, Illinois *Senior Vice President* PAUL C. BUCKNAM, JR., Wellesley, Massachusetts *Vice Presidents* EDWARD W. DAVIDSON, JR., Atlanta, Georgia CHRISTOPHER MARX, New Haven, Connecticut JAMES E. (BUD) MOULDER, St. Louis, Missouri ROBERT J. SMITH, Seattle, Washington RICHARD L. WILLIAMS, Roanoke, Virginia *Treasurer* LESTER H. SMITH, JR., Nashville, Tennessee *President-Elect* ARNOLD L. WINDMAN, New York, New York *Executive Vice President* LARRY N. SPILLER

assist the Committee in reestablishing small business programs which foster small business development.

Small Business Procurement

As you know, ACEC for several years has been frustrated by the Small Business Administration's perceived lack of responsiveness to and understanding of the needs of small business in general and the engineering profession in particular. As the Committee knows, new service-oriented businesses made up the largest share of new enterprises in 1983. We question the Small Business Administration's success in recognizing the inherent changes in small business needs resulting from this economic shift. The SBA's attempt to establish a size standard reflective of the engineering industry is a case in point.

Over the past five years, the SBA has proposed four different size standards for the engineering industry. In each instance, the agency rationale used to support the proposed standard varied substantially from the previous proposal. ACEC has become alarmed that the SBA continues to place increased emphasis on establishing a size standard which will facilitate federal agency requirements to fulfill Congressionally-mandated small business utilization goals rather than establishing a small business threshhold based on the industry's make-up. The result has been the establishment of an artificially inflated size standard for a highly competitive industry that serves to suppress, rather than enhance, competition. Currently, small, emerging firms must compete for procurement assistance with firms that have, on average, been in business for twenty-five years (Consulting Engineer, "1984 Census of Firms, June 1984, p. 64.). It stands to reason that the truly small, emerging firm would quickly become discouraged from participating in federal procurement assistance programs when faced with competition from these long-established firms.

ACEC respectfully suggests that this Committee closely examine the small business size standards/set-asides relationship to ensure that procurement preference programs are targeted toward those firms most in need of assistance to become viable in the open market place and are not merely promulgating a "numbers game" to assist agencies to attain small business utilization goals. Increasing size standard threshholds in competitive industries such as the engineering profession only serves to enable agencies to more easily attain small business utilization goals; it does nothing to expand the universe of small firms presently unable to compete.

Minority- and Women-Owned Business Programs

ACEC believes it is important that bona fide socially and economically disadvantaged businesses be capable of competing for procurement contracts, both in the 8(a) programs and in the open market place.

The current method of contracting under the 8(a) program severely restricts the development and exercising of fundamental business skills necessary for competing successfully in a less-sheltered market place. We believe that no amount of technical and management assistance can equal benefits to be derived from requiring firms to compete for contracts on an equal basis with their peers within a sheltered market place.

The 8(a) program, historically, has not significantly benefitted minority and women-owned engineering firms. Sole-sourcing of contracts has not assisted these firms in acquiring the professional acumen to compete with other firms through a procurement system based on qualifications rather than lowest price. For the engineering profession, development of a scope of work suitable in meeting client needs, project presentation, efficiency in project management and quality of design are skills that can generally only be attained through the exercise of competing with other firms.

The Veterans Administration has recently undertaken a progressive approach for procuring 8(a) architect-engineering services. In instances when at least three 8(a) architect-engineering firms can be identified as qualified to perform a specific scope of work, these firms are solicited to compete for the project based on procurement methods consistent with 40 U.S.C. 541 et seq. ACEC applauds the Veterans Administration's initiative in establishing this program and we continue to encourage similar programs within other agencies.

ACEC encourages this Committee to explore legislation which would require the award of federal architect-engineer contracts to 8(a) firms through a quality-based procurement process.

Subcontracting

In addition, ACEC suggests that your Committee investigate the level of subcontracting to small and small disadvantaged firms. We believe development of and compliance with subcontracting plans is a "weak link" in agency strategies to enhance small and small disadvantaged business utilization. To become viable, small and small disadvantaged businesses need a mix of prime and subcontracting experience. Subcontracting provides firms with the opportunities to observe (1) the operation of large firms; (2) management techniques and requirements of large projects; and (3) how client contacts are developed and maintained.

Currently, no data indicating the extent of subcontracting opportunities in any given industry category seems to be available. ACEC believes that this information would be valuable to SBA in determining which federal contracts should be set-aside for small and small disadvantaged firms for prime and subcontracting opportunities to insure that the federal procurement process provides equitable business development opportunities for small business enterprises in all industry categories.

Conclusion

ACEC does not believe that it is in the nation's best interest to abolish the Small Business Administration and transfer the majority of its current programs, intact, to other agencies. To do so would harm the effectiveness of SBA's successful activities, while doing nothing to correct present inadequacies in other SBA programs. Instead, ACEC believes that this Committee should carefully examine the effectiveness of each SBA program in promoting increased opportunities for firms to compete and grow competitively by utilizing the authorization process to fine-tune SBA's various program to more responsively, effectively and efficiently assist firms to become viable in the marketplace.

ACEC offers its continued assistance to the Committee to achieve these goals.

Sincerely,

William J. Birkhofer

William J. Birkhofer
Managing Director
Governmental and
International Services

Liberty National Bank

Los Angeles Loan Production Office
11222 La Cienega Blvd., Suite 471 • Inglewood, California 90304 • (213) 645-2673

February 7, 1985

Mr. R. Michael Haynes, Chief Counsel
U.S. Senate Committee on Small Business
428AA Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Haynes:

I enjoyed meeting you with Katherine Lyons and Biff Barnard the other day as a representative of the National Association of Government Guaranteed Lenders.

I am a Sr. Vice President and Manager of Liberty National Bank's Small Business Administration program. Liberty National Bank is Southern California's leading generator of Small Business Administration loans and the sixth largest bank generator of SBA loans in the United States.

Since Liberty National Bank participation in the SBA program, we have funded over 90 loans exceeding $28 million.

Liberty National Bank is committed to the SBA program and believe it is an important financing avenue for many small businesses. During the year and a half that Liberty National Bank has been involved in the program, our clients have generated an additional 400 new jobs through the funding of SBA loans. This represents a thirty percent increase in their employment base. We feel that this statistic speaks well for the program and Liberty National Bank is pleased that we able to contribute to contribute in the nations economy in this manner.

Liberty National Bank has operated under the Small Business Administration's Quality Loan program and our portfolio is excellent. We adhere to a internal bank policy of utilizing SBA financing for established businesses who are seeking SBA financing to support their sales growth.

For your information, I am enclosing five letters from our succesful client who without SBA financing would not be as successful as they are today.

I understand that your committee will be holding hearings on this matter in the near future. If you would like participation from our bank or any of our clients, please feel free to contact me to arrange this.

In the meantime, per your request we are procuring written testimony to be submitted to your committee. I look forward to hearing from you in the future.

Sincerely,

Robert J. Coleman
Sr. Vice President

KIRKHAM-ANDERSON, INC.
General Contractors and Contents Restoration

MAIN OFFICE
17751 MITCHELL
IRVINE, CA 92714
(714) 953-1763
(213) 630-0319
LICENSE NO. 444014

January 22, 1985

Mr. Robert Coleman
Senior Vice President
Liberty National Bank
11222 La Cienega Blvd., Ste. 471
Inglewood, Ca. 90304

Dear Mr. Coleman:

We received our year end review financial statements dated October 31, 1984. This was an exceptional year with sales in excess of $3.5 million and earnings before income tax of $115,000.00. 1985 promises to be an even more successful year with a backlog of $1 million in uncompleted contracts.

The purpose of this letter is to personally thank Liberty National Bank and the SBA. Our success without the SBA would have been impossible. It was the infusion of capital into Kirkham-Anderson that allowed us to purchase necessary assets and make our company into a viable organization and well respected within our industry.

What is also pleasing to me is the SBA loan allowed us to create internal jobs and increase our working staff to approximately 35 people. As you know, our organization one year ago had only 5 or 6 employees.

This dynamic growth, success and job opportunities for our Kirkham-Anderson Company would not have been possible without our SBA loan. On behalf of Kirkham-Anderson, Inc., may I thank you and wish you continued success and happiness in 1985.

Sincerely,

KIRKHAM-ANDERSON, INC.

Roger C. Kirkham

Roger C. Kirkham
President

RCK:jd

cc: Larry Kolson

Serving: Los Angeles, Orange, Riverside, San Bernardino, and San Diego Counties

Freight Data Systems

8841 Airport Blvd
Suite 426
Los Angeles CA 90045
(213) 215-1741 (213) 991-8042

January 22, 1985

Mr. Robert Coleman
LIBERTY NATIONAL BANK
One Pacific Plaza
7777 Center Avenue
Huntington Beach, CA 92647

Dear Mr. Coleman

Per your request regarding the changes provided by the SBA loan program, I have listed below the major enhancements made available to Freight Data Systems.

Since the loan funding, FDSI has increased staff personnel from twenty to forty. We have opened an East Coast office and have increased fixed assets by 50%.

Freight Data Systems has experienced substantial improvements in performance, products and future growth prospects. Sales have increased from $2 million to $3 million.

Thank you again for your efforts in helping Freight Data Systems obtain the SBA funding, which has not only helped us meet our contractual obligations, but has also given us a firm base for future expansion.

Regards,

FREIGHT DATA SYSTEMS, INC.

Larry W. Boecker
President

LWB/lr

er locations 28901 Agoura Road Agoura, California 91301 (213) 991-8042 FDS Limited 2 Market Street Braintree, Essex CM7 6XT England 044-0376-47274
3460 Chestnut Street, San Francisco, California 94123 (415) 929-7490 Post Office Box 1278 GPO New York New York 10116 (201) 434-0500

Catalina Cylinders Corporation

Janauary 21, 1985

Mr. Robert Coleman
Liberty National Bank
11222 La Cienega Blvd. Suite 471
Inglewood, CA. 90304

Dear Bob,

This is just a brief note to let you know what opportunities our Small Business Administration loan has given us. First of all, we wouldn't be here if it weren't for it, second of all, it has increased job opportunites within our small (but growing) company. We will eventually have a minimum of 25 new employee openings by the time we are 100 percent in production.

We sincerely hope the S.B.A. continues to fund new loans to small businesses throughout the United States. We feel that small businesses are the backbone of this country's well being.

I hope your trip to Washington, D.C. is successful.

Yours very truly,
Catalina Cylinders Corp.

Ian P. Albert
President

IPA/ta

5322 OCEANUS DRIVE • HUNTINGTON BEACH, CA 92649 • TELEPHONE (714) 898-3058

HVT

Ted Hammett
Vacuum
Truck Service .... Phone (213) 435-7847

903 McDonough St.
Wilmington,CA 90744

January 22, 1985

We received $550,000.00 from S.B.A. October 1983, to consolidate our company liabilities and to expand our facility in industrial liquid waste.

With the financial support of the S.B.A. we were able to diversify our operation to assure future profit. We purchased a clarifier and expanded our capabilities as an industrial waste treatment facility which will automatically increase profits by a minimum of 20%. With the installation of this equipment extra specialized personnel were needed to be employed.

Without the S.B.A. back loan we feel it would be extremely difficult to compete with the larger transportation companies in the hazardous waste transportation field which is constantly changing and growing. We have increased our sales by providing more specialized equipment and personnel to render services requested.

We would like to convey our appreciation to [illegible] National Bank for their professional relationship with Hammett Vacuum Truck Service and look forward to continued business.

Very truly yours,

Ted C Hammett

TED C. HAMMETT
VICE-PRESIDENT

TCH/br

Severinos
1000 Wilshire Boulevard • Santa Monica • CA 90401
Phone: (213) 395-1000

Ronald Reagan
President of United States
Washington, D.C.

Dear Mr. President:

I've heard the news that you're considering planning to do away with the SBA loan program. If this is true, it's a shame. The SBA loan program plays a vital part of the new business financing. In many cases, the only financing available to allow people to start up businesses, as most lenders will not consider start-up loans.

I was able to obtain an SBA loan and it was my one source of finance to start my business. This program not only helped me to pursue my dreams, but it has provided jobs for fifteen people. These fifteen people are able to provide the necessities of life to their families, resulting in fifteen families possibly off the relief rolls of this country.

I hope you reconsider your decision to abolish the SBA loan program, as it is a vital form of financing, not only for today, but the future as well.

Respectfully Yours,

Michelle Nilsson
Owner

MN:ld

CANDO

Chicago Association of Neighborhood Development Organizations

March 28, 1985

The Honorable Senator Lowell Weicker, Chairman
U.S. Senate Committee on Small Business
FR 428 A Russell Office Building
Washington, D.C. 20510

Dear Senator Weicker:

The Chicago Association of Neighborhood Development Organizations (CANDO) is a not-for-profit coalition of community organizations, chambers of commerce, business associations and local and certified development companies in the City of Chicago.

On Saturday, February 16, 1985 representatives of our organization met with your staff member, Robert Wilson, to discuss the future of the Small Business Administration in light of the Administration's proposed budget cuts.

Attached please find the transcriptions of the testimony given at that meeting by current SBA borrowers, bankers actively involved with SBA programs and representatives of local and certified development companies in Chicago.

We ask that you make the enclosed transcriptions of testimony a part of the Congressional Record.

CANDO has prepared a brief three-page summary of the testimony for some highlights. You will find that enclosed with this letter as well.

Sincerely,

Ted Wysocki

Ted Wysocki
Executive Director

222 West Adams Street Suite 1398 Chicago, Illinois 60606 (312) 845-9646

CANDO

Chicago Association of Neighborhood Development Organizations

Excerpts from Testimony

February 16, 1985
South Shore Country Club
7100 South Shore Drive
Chicago, Illinois

Proposed Federal Budget Cuts
and the Future of the U.S.
Small Business Administration

From Current SBA Borrowers

Leon Jackson, President of Bills Sheets and Blind Company, Chicago, Illinois.

"It's difficult for bank users to get a small business loan through a loan committee, especially when it's located in an area of the city that everybody's written off, with a loan applicant that perhaps does not have a track record, or the connections to make that loan."

"Through the efforts of a number of people we were able to locate a small business that was basically deteriorated. Not because of the market, but because the owner was 85, had been in the business for sixty years, employed 15 people and basically everyone walked to work. But the business had no financial records. The business had very little track record that you could put a handle on. My experience told me that it was a viable business...And today, we are just coming toward the end of our first fiscal year . . . we are operating at break even. The time of year that is usually the worst time is this time, January and February. Our sales are up, and instead of cutting back people we have been able to maintain and not lay off."

Lee Sanders, Regional Manager for National Icee Corporation, Chicago, Illinois.

" SBA came out, and they did loan the money that we needed to expand our operation. We have now expanded our operation, and we have increased sales over last year by more than 20%. . . . Without finding funds, we would not be able to employ many of the people that we are employing now."

Ernest Ojeda,Owner of Two McDonald's Franchises, Chicago, Illinois.

"We received ... a loan, a direct loan, from the SBA in excess of $200,000 at a fixed rate of 8¼%. Today my wife and I have a total number of employees of 180, our annual payroll is in excess of $600,000, and we collect over a quarter of a million dollars a year in sales tax that goes to both the mayor and the governor."

Gerald Gomez, Owner, Midwest HAPCO, Inc., Chicago, Illinois.

"Back in 1980 I started a small shop . . . where we manufactured plating racks. Without SBA I could not have obtained the two factories that I own now.. When I bought Midwest HAPCO they were on the edge of going out of business. We would have ended up with an empty building and ten people without a job. We were able to save those jobs and bring some more jobs into the neighborhood where I am now, Austin."

222 West Adams Street Suite 1398 Chicago, Illinois 60606 (312) 845-9646

Hank Mendoza, President, Mid-America Environment Services, Chicago, Illinois.

"I purchased a company two years ago that was bankrupt. It had three employees left and it was being liquidated; it was three months from liquidation. We turned the company around with the help of an SBA loan as well as some MESBIC financing, including debentures. In two years we have over $5 million in sales and we have over 15 employees."

From Community Banks in Chicago Participating with SBA Programs

William L. Baxter, Senior Vice President, Albany Bank and Trust Company N.A.

"We have been a strong participant in the SBA program for over ten years with $3 million in SBA loans currently outstanding, 99% of which are performing precisely according to terms. The program [SBA] is particularly critical in our immediate trading area due to the high density of ethnic entrepreneurs, who because of their humble economic origins, and while long on integrity and ability as businessmen,are typically short on the essential ingredient — capital. "

James Hadley, Senior Vice President, Community Bank of Lawndale.

"But I think the bottom line is this. Despite whatever problem we have with the SBA, it is by far the best vehicle we have to aid the small business person in his financial dealings."

Gilbert Bland, Independence Bank.

"Our loans are primarily geared to minority buisnesses, particularly black businesses, on the south side of Chicago. Contrary to some public statements [about SBA loans] these are not companies that are not credit worthy. In some situations due to inadequate equity base, the bank needs actual protection. . . . Approximately four years ago, a company we are doing business with now began . . . today we watch a company in four years start from zero to now over $2 million in sales. Jobs are in excess of 20. They are now capable of getting contracts in the private sector through competitive bidding."

From SBA-Certified Development Companies

James Lemonides, Executive Director, Greater North Pulaski Development Corporation.

"Our first experience with the SBA 502 program, in 1979 was on behalf of the Jimenez Family. From humble beginnings as a butcher [Mr. Jimenez] in Chicago's southwest side, he proceeded to open his own 1500 square foot market and move his business to our community in 1976. Based on hard work, sound management and aggressive marketing by 1979 he had expanded to include a supermarket, liquor store, clothing and gift shop in over ten times the space. We were able, through the Section 502 loan, guaranty program, to assist Mr. and Mrs. Jimenez to acquire a vacant and deteriorating building in our changing neighborhood and continue the expansion of their business.

"An example from our industrial community - When the Schwinn Bicycle Company pulled out of our neighborhood this year, the SBA 503 program was instrumental in bringing in another minority enterprise into one of the vacant buildings. Currently Solor Spring Company employs 50 people and expects to add ten more — all community residents."

Julia Girsch, Executive Director, Beverly Area Local Development Company.

" Over the past eight years, we have secured 25 SBA loans totaling approximately $ 5.5 Million. These loans have preserved 175 jobs and created 78 additional jobs."

Diane Pyshos, Director of Financial Services, Lawrence Avenue Development Corporation.

"We use SBA selectively for only those businesses which can demonstrate the need for such financing. SBA financing tools are only a part of our total program, however, an integral part. Without the stimulus of business growth made possible by SBA programs, the private investment we have generated on Lawrence Avenue might not have occurred. The local climate is ripe for investment and growth, if only the national economy would not prevent it from happening."

Lynne Cunningham, Executive Director, South Chicago Development Commission.

" Twenty-one thousand people in our community are out of work right now beacuase of the impact of the steel industry and other heavy manufacturers in South Chicago. It is our theory based on what we have seen in the last couple of years, that it is a much more productive use of our time to spend the time working with ten businesses that are going to add ten jobs than it is to spend all of our time working with someone who may in the future provide 6,000 jobs . We will work with the entity that may produce 6,000 jobs, but those are so few and far between that we are much better off looking at our own back yard and finding those people who are in business, who either want to sell to the next generation or to management, or who have a good idea whose time has come and may be able to hire five of their neighbors.
SBA has played a very important part and will continue to play an important part if we can keep it going. . . .It's too bad that Mr. Stockman, Sr. is not a small business person, because he would probably say the same thing that Mrs. Stockman said - that her son is just wrong this time and that we need to vote for SBA in the future. "

Testimony of James S. Lemonides, Vice President and Executive Director

Greater North Pulaski Development Corporation
4054 West North Avenue, Chicago Illinois 60639
Meeting on the Future of the U.S. Small Business Administration
United States Small Business Committee
South Shore Country Club
Saturday, February 16th, 1985 9:30 A.M.

Good morning, and thank you for the opportunity to speak before the committee today. My name is James Lemonides, and I am representing the Greater North Pulaski Development Corporation, which serves a nine-square mile area on Chicago's northwest side. Our organization is certified by the SBA as both a section 502 and 503 local development company. Our service area is home to about 250,000 people, approximately sixty percent of whom are Hispanic, and twenty percent of whom are Black. I am speaking today, not only as executive director of our corporation, but as a board member, and as a resident and property owner within the area we serve.

Recent editorials and testimonials would have us believe that SBA loan applicants and recipients are losers, or in some way not "desirable" businesses worthy of governmental assistance. We are being asked to believe that SBA clientele are not consistent with the American ideal of self-help and "pulling oneself up by the bootstraps". And we are being asked to accept the proposed abolition of the SBA altogether. On the basis of our four years of experience in making the programs work in our community, we challenge the assumptions of SBA critics, and strongly disagree with their conclusion.

The best argument we can make is through example. Our first experience with the SBA 502 program, in 1979, was on behalf of the Jimenez family. Jose Jimenez immigrated from Mexico to Chicago in the early 1970's. From humble beginnings as a butcher in Chicago's southwest side, he proceeded to open his own 1500 square foot market, and moved his business to our community in 1976. Based on hard work, sound management, and aggressive marketing, by 1979 he had expanded to include a supermarket, liquor store, clothing and gift shop in over ten times the space. We were able, through the section 502 loan guarrantee program, to assist Mr. and Mrs. Jimenez to aquire a vacant and deteriorating building in our changing neighborhood, and continue the expansion of their business. All employees are minority residents of the neighborhood. The project was crucial to the integrity of our community, because it provided graphic proof that minority entrepreneurs are just as solid and just as valuable to neighborhood business development as the older non-minority business people. Pioneer Bank and Trust Company would not have participated as principal lender, and the project would not have happened without the SBA 502 guarantee. There are two reasons why Mr. Jimenez is not here to state this case himself: first, he is not fluent in English, and somewhat shy about public speaking; second, and perhaps more telling--he is now incredibly busy. In October of 1984 the Jimenez were selected as one of the top 100 Latino businesses in the country, and flew to Amarillo to accept an award. They have not looked for any additional SBA assistance, because their hard work, sound management, and aggressive marketing continues today; and they have been able to grow and create jobs all by themselves.

We have another example from our industrial community. When the Schwinn Bicycle Company pulled out of our neighborhood this year, the SBA 503 program was instrumental in bringing another minority enterprise into one of the vacant buildings. Currently, Solar Spring Company employs fifty people, and expects to add ten more--all community residents. As the expansion of this viable small industry shows, the premise that SBA clients all run taverns is pure fiction.

We have other examples--7A guarantees and section 503 debenture projects. But time constrains us this morning. Our loan packaging work has embraced these programs and made them productive within our community. SBA's program guidelines helped us to set up the structure and the staff capability through which we have packaged over $8 million worth of neighborhood business expansion, affecting over 400 jobs. The loss of these SBA programs would severely impair our continued success. On behalf of the businesses we have represented in the past, and those we hope to represent in the future, we respectfully and strongly urge that the programs be continued and, if possible, expanded.

I thank you again for the forum you have provided today, and the opportunity you have provided for us to be heard.

BAPA
Beverly Area Planning Association
9730 S. WESTERN AVENUE
CHICAGO, ILLINOIS 60642
TELEPHONE 312/233-3100

February 13, 1985

Mr. Robert Wilson
c/o Chicago Association of Neighborhood
Development Organizations
222 W. Adams, Suite 1398
Chicago, IL 60606

Dear Mr. Wilson:

Due to a prior commitment, I am unable to attend the briefing session on Saturday, February 16. I have requested that a representative from CANDO speak on our behalf.

The Beverly Area Local Development Company was incorporated in 1977 to serve as a conduit for SBA loans for local businesses. Over the past eight years, we have secured 25 SBA loans totaling approximately $5.5 million. These loans have preserved 175 jobs and created 78 additional jobs.

While we acknowledge the fact that a number of these businesses may have been able to secure conventional financing, the majority of them needed the reduced interest rate or extended term that the SBA loan provided. The availability of SBA financing enables the entrepreneur to establish a business or expand an existing one. This serves to reduce vacancies, stabilize commercial areas, and create job opportunities.

The SBA loan program has been a vital component of our economic development activities. All studies readily identify small businesses as the backbone of the American economy. To eliminate this key economic development tool at this time is unthinkable. It would only serve to undermine the slow, but none-the-less apparent, recovery that the small business community has seen in recent years.

On behalf of the concerned business community in which I work, I strongly urge the U.S. Senate Small Business Committee to recognize that the Small Business Administration loan programs are critical to the preservation of our small businesses, and to maintain these programs as they presently exist.

Sincerely,

Julia B. Girsch

Julia B. Girsch
Executive Director
Beverly Area Local Development Corporation

JBG/dw

BAPA is a non-profit civic organization, founded in 1947

ALBANK

PUBLIC STATEMENT FOR RELEASE BY ALBANY BANK AND TRUST COMPANY N.A.
RELATIVE TO THE IMPORTANCE OF THE SBA PROGRAM

Albany Bank and Trust Company N.A. is very active in extending commercial loans to small and medium sized businesses with specific emphasis on the immediate trading area which encompasses a radius of approximately three miles of its principal place of business at the intersection of Kimball and Lawrence Avenues. Additionally, we are instrumental in the extension of business loans throughout the metropolitan Chicago area and are further involved in the financing of leased medical equipment to hospitals on a nationwide basis.

We have been a strong participant in the SBA program for over ten years with $3 Million in SBA loans currently outstanding, 99% of which are performing precisely according to terms. Since being designated as a "Certified Bank" under the SBA program we have been able to expedite the extension of credit on a basis heretofore not possible to the small and medium sized business community.

The program is particularly critical in our immediate trading area due to the high density of ethnic entrepreneurs, who because of their humble economic origins, and while long on integrity and ability as businessmen, are typically short on the essential ingredient -- capital. By providing SBA support for extension of credit in these situations we have been able to provide these entrepreneurs with a vehicle to create new products, new markets, and most importantly new jobs in our immediate area and outlying neighborhoods. The direct benefit to our community, which is made up of middle and low income families, is immeasurable in terms of economic growth and job stability.

These benefits of the SBA loan program have been dramatically illustrated in two specific instances in the last five years. In 1980 Jack Magierek, President of Raguard Rapid Print, Ltd. of Chicago, Illinois was named Illinois SBA "Man of the Year". Our initial loan for start-up was made to him in 1978 and has since that time grown from zero dollar sales to figures now approaching $1.5 Million annually -- a new business and of equal importance -- new jobs. Another dramatic achievement is the success of Scientific Information Retrieval, Inc. located in Evanston, Illinois. In 1978 we made a loan to the principals, Eli Cohen and Barry Robinson, two Professors from Northwestern University, to develop a software program to be utilized by the research departments of prestigious National and International Universities. Sales at the date of our initial loan were zero dollars. We anticipate that the company will produce revenue of $5 Million in the fiscal year end 1985. The software program which they continue to further perfect is not only utilized by said Universities but the R & D Divisions of National Companies.

ALBANK

Not only has a new product been developed but we have been able to export this product and create many new jobs.

Aside from the achievement of these individuals and their businesses is the remaining constant all important factor — new jobs. What better investment can be made of the tax dollar. We have 30 other SBA success stories on our books, copies of which are available upon request.

William L. Baxter, Senior Vice President
February 15, 1985

LAKEVIEW
CENTRAL

**LAKEVIEW CENTRAL
BUSINESS ASSOCIATION**

**3245 N. SHEFFIELD
CHICAGO, IL 60657
281-7705**

- **PRESIDENT:
CAROL GROCHOWSKI
LOOKS**
- **VICE PRESIDENT
SAM TOIA
LEONA'S**
- **TREASURER:
JAMES O'CONNOR
RANDOLPH OFFICE SUPPLY**
- **SECRETARY:
ANNA GLOWACZ
LA PENTOLA**

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THEATER BUILDING**
- **JOHN AUGUSTINE
ROCKET 69**
- **ARTHUR BLASCHKE
BELMONT NATIONAL BANK**
- **EXECUTIVE DIRECTOR:
TIM SULLIVAN**

February 20, 1985

Robert Wilson
c/o CANDO
222 W. Adams St.
Chicago, Il. 60606

Dear Mr. Wilson:

As Executive Director of the Lakeview Central Business Association, I represent over 200 businesses in the Lakeview Central community on Chicago's northside. I also have over 7 years of experience in neighborhood commercial development.

It has come to my attention that the current administration's budget is calling for the elimination of the SBA and with it its 7a and 503 loan programs.

Dealing from my experience as a neighborhood development practitioner, I feel that the elimination of these programs would have a very negative and devastating affect on our neighborhood commercial strips.

Therefore, I encourage you to do everything in your power to have the current administration retain the SBA and its current loan programs that I have seen put to good use in many of our Chicago neighborhoods.

Thank you for your time and consideration.

Sincerely,

Tim Sullivan

Tim Sullivan
Executive Director

BELMONT • SHEFFIELD • CLARK • HALSTED • RACINE

[From the Detroit News, Feb. 19, 1985]

INVENTORS EARN NATIONAL AWARDS

(By Jon Thompson, News Special Writer*)

TRAVERSE CITY.—Their work had been pretty much over-looked for three decades, but at the White House today, John T. Parsons and Frank L. Stulen, both of Traverse City, finally are receiving recognition for an invention some engineers say started the "Second Industrial Revolution."

President Reagan will present National Medal of Technology awards to Parsons, 71, Stulen, 64, and seven others from across the nation. The winners were picked from among 120 nominees.

Parsons and Stulen together developed a process for the highly precise cutting and grinding of metal parts. They provided breakthrough technology for the mass production of large jet aircraft and rocketry after World War II.

Now semi-retired, Parsons is the former president, of Parsons Co., once the world's largst producer of helicopter blades, Stulen, a part-time consultant, was Parson's research chief.

In 1980 Congress authorized the National Medal of Technology to be given annually to no more than 12 persons, or U.S.-owned companies, in recognition that they have used science and engineering to advance American technology in world markets.

Today's bestowal of the awards marks the first time the White House has paid tribute for the practical application of scientific ideas.

Parsons' and Stulen's early 1950s invention uses electronic impulses directed by punch cards and punch-paper tapes to control and operate machines. Before, workers had to tediously guide the milling machines' operations. But it became clear that the hand could not move with the accuracy or efficiency needed for intricate, jet-age designs utilizing new and sensitive materials in mass production.

Parsons and Stulen were aware of this. They were caught up in the then high-technology of producing blades for another relatively new invention—the helicopter. They determined to address the problem when Lockheed Corp. won a bomber contract and had to have the invention before it could proceed.

Parson's company bid to build the machining equipment, won the contract in 1949 and turned out the first machine in 1952.

Their machines largely have given way to computer-directed machines since, but their contribution has lost none of its importance, specialists say. More than half of all the expensive machine tools built in the United States today can be traced to the numerical control patents the two developed.

"Nobody believed in it at first," recalls Parsons. "It took several years for the idea to take off."

Some manufacturers recognized the potential, however. A leading machine tool firm offered Parsons $10,000 for the patent. Parsons thought it was worth much more—a belief that eventually paid off.

Aware his company could not mass produce the new machines, Parsons licensed the process to Bendix for $30,000 plus royalties that continue to roll in. The firm that offered $10,000 for the patent wound up paying $300,000 just to use the process.

Parsons grew up in Grosse Pointe and attended Wayne State University for a year before giving up on academe. He had begun his career in industry at his father's Detroit machine shop when he was 14.

He did various jobs in the plant then got into sales. By the time he turned 17, Parsons was handling the Chrysler Corp. account. As a salesman from the age of 20 to 27, he increased sales 2,700 percent.

Then during World War II, he headed a committee to produce war goods faster. Eventually he founded a company to turn out land mines and later, helicopter parts.

Stulen, who has been vacationing out of town prior to picking up his award, is a native of Pennsylvania and a graduate of Pittsburgh's Carnegie Institute. He served with the U.S. Army Corps of Engineers before joining Parsons' company in 1946.

Stulen now divides his time between travel and helping a Traverse City firm create a new line of cutting tools.

"I can't think of anyone I would rather share the award with than John Parsons," said Stulen in a phone interview. "I try to tell people about numerical control but most of them don't know what it is."

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*News staff writer James L. Kerwin contributed to this report.